U.S. TRUSTEE PROGRAM

ARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

JULY 24, 1996

Serial No. 87

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

35–307 CC WASHINGTON : 1996

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-053733-9

10 4

U.S. TRUSTEE PROGRAM

ARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

JULY 24, 1996

Serial No. 87

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

35-307 CC WASHINGTON : 1996

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-053733-9

COMMITTEE ON THE JUDICIARY

HENRY J. HYDE, Illinois, *Chairman*

CARLOS J. MOORHEAD, California
F. JAMES SENSENBRENNER, Jr., Wisconsin
BILL McCOLLUM, Florida
GEORGE W. GEKAS, Pennsylvania
HOWARD COBLE, North Carolina
LAMAR SMITH, Texas
STEVEN SCHIFF, New Mexico
ELTON GALLEGLY, California
CHARLES T. CANADY, Florida
BOB INGLIS, South Carolina
BOB GOODLATTE, Virginia
STEPHEN E. BUYER, Indiana
MARTIN R. HOKE, Ohio
SONNY BONO, California
FRED HEINEMAN, North Carolina
ED BRYANT, Tennessee
STEVE CHABOT, Ohio
MICHAEL PATRICK FLANAGAN, Illinois
BOB BARR, Georgia

JOHN CONYERS, Jr., Michigan
PATRICIA SCHROEDER, Colorado
BARNEY FRANK, Massachusetts
CHARLES E. SCHUMER, New York
HOWARD L. BERMAN, California
RICK BOUCHER, Virginia
JOHN BRYANT, Texas
JACK REED, Rhode Island
JERROLD NADLER, New York
ROBERT C. SCOTT, Virginia
MELVIN L. WATT, North Carolina
XAVIER BECERRA, California
ZOE LOFGREN, California
SHEILA JACKSON LEE, Texas
MAXINE WATERS, California

Alan F. Coffey, Jr., *General Counsel/Staff Director*
Julian Epstein, *Minority Staff Director*

Subcommittee on Commercial and Administrative Law

GEORGE W. GEKAS, Pennsylvania, *Chairman*

HENRY J. HYDE, Illinois
BOB INGLIS, South Carolina
STEVE CHABOT, Ohio
MICHAEL PATRICK FLANAGAN, Illinois
BOB BARR, Georgia

JACK REED, Rhode Island
JERROLD NADLER, New York
ROBERT C. SCOTT, Virginia
ZOE LOFGREN, California

Raymond V. Smietanka, *Chief Counsel*
Charles E. Kern II, *Counsel*
Roger T. Fleming, *Counsel*
Agnieszka Fryszman, *Minority Counsel*

CONTENTS

HEARING DATE

OPENING STATEMENT

WITNESSES

LETTERS, STATEMENTS, ETC., SUBMITTED FOR THE HEARING

APPENDIX

U.S. TRUSTEE PROGRAM

WEDNESDAY, JULY 24, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL AND
ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2226, Rayburn House Office Building, Hon. George W. Gekas (chairman of the subcommittee) presiding.

Present: Representatives George W. Gekas, Bob Inglis, and Jack Reed.

Also present: Representative Bob Goodlatte.

Staff present: Raymond V. Smietanka, chief counsel; Charles E. Kern II, counsel; Peter J. Levinson, counsel; Rebecca Ward, secretary, and Agnieszka Fryszman, minority counsel.

OPENING STATEMENT OF CHAIRMAN GEKAS

Mr. GEKAS. The hour of 10 o'clock having arrived, this hearing of the Subcommittee on Commercial and Administrative Law of the House Committee on the Judiciary will come to order.

We recognize the gentleman from Rhode Island, Mr. Reed, the ranking minority member, whose presence here, along with that of the Chair, constitutes a hearing quorum. We will proceed.

Does the gentleman wish to make an opening statement?

Mr. REED. Yes, thank you, Mr. Chairman. I just want to welcome the witnesses and apologize in advance for having to leave early. Mr. Scott and I have a markup going on in another committee, and I know there are other members on our side who also have conflicts with other subcommittee assignments, but I want to assure the witnesses that we will review the transcript carefully.

I'd also ask, Mr. Chairman, unanimous consent that any member who has questions, but is unable to be here because of a conflict, be allowed to submit them in writing to the panel.

Mr. GEKAS. Without objection, so ordered.

Mr. REED. Thank you, Mr. Chairman. Thank you.

Mr. GEKAS. Everyone knows that we have responsibility in this subcommittee for the bankruptcy system. More and more, almost every day, we see evidence that it is important to give the public the clearest possible view of a system that we hope equitably and efficiently discharges its duties.

And how do we go about doing the things necessary to ensure the confidence of the public? Since 1978, the form, functions, and structure of the U.S. Trustee Program have been examined many times,

mostly by our predecessor subcommittee. Most recently, we have the 1993 GAO study, the National Academy of Public Administration report, the American Bankruptcy Institute's symposium, and the forthcoming analysis by the National Bankruptcy Review Commission. We all hope that the record of this hearing, with as many witnesses as we have before us today, will add to the understanding of these reports and help clear up misunderstandings, if any there be.

Now we notice that 10 of our 11 witnesses have come from places outside Washington: Los Angeles, CA; Phoenix, AR, Ann Arbor, MI; Chicago, IL; and near Newcastle, PA, Youngstown and Cleveland, OH; also Nashville, TN; Buffalo, NY; Lynchburg, VA; and Columbia, SC. This is a national forum we're conducting here today, and we appreciate your adjusting your own schedules to appear before us.

We'll begin with the first panel, which is made up of Joseph Patchan, Director, Executive Office for U.S. Trustees; M. Scott Michel, Regional U.S. Trustee, and Clarkson McDow, Regional U.S. Trustee.

I thought I recognized the name Michel. Actually, Bob Michel is better known as the soloist accompanying my performances on the piano than he was as minority leader, and I want you to know that and remind him of that.

Mr. MICHEL. He reminded me.

[Laughter.]

Mr. GEKAS. Well, all right, thank you.

Why don't we begin in the order that we announced the membership of the panel, with Mr. Patchan, the Director of the Executive Office for U.S. Trustees. You may proceed.

STATEMENT OF JOSEPH PATCHAN, DIRECTOR, EXECUTIVE OFFICE FOR U.S. TRUSTEES, DEPARTMENT OF JUSTICE

Mr. PATCHAN. Mr. Chairman, Mr. Reed, thank you for this opportunity to talk to you about the U.S. Trustee Program. My name is Jerry Patchan, and as you've mentioned, I am the Director of the Executive Office for U.S. Trustees. I have held that position since December 1994. I have been a bankruptcy lawyer for more than 40 years, served on the bankruptcy bench, and recently before I came to the U.S. Trustee Program, served as Deputy General Counsel for the Resolution Trust Corporation, where I had charge of the RTC's large bankruptcy docket, among other things.

With me are Scott Michel and Clarkson McDow, both U.S. Trustees. Mr. Michel is headquartered in Chicago, and pending the swearing in of the new U.S. Trustee, he is also covering our Philadelphia region. Mr. McDow is headquartered in Columbia, SC. They will provide their own perspective on the program based on their experience.

The U.S. Trustee Program was established to be the watchdog over bankruptcy administration. The bankruptcy system today faces a dramatic increase in bankruptcy filings. Over the 12-month period ending March 31 this year, chapter 7 and chapter 13 filings have increased approximately 17 percent, and during that same period the decline that we've seen in recent past years of chapter 11 business filings seems to have leveled off and may, indeed, begin

to rise. For the first time in our Nation's history, bankruptcy filings may well exceed 1 million cases within a 12-month period.

The U.S. Trustee Program faces increased workload after several years of austerity. The program's full-time, onboard personnel have been reduced by more than 15 percent over the past 3 years. Our budget remains virtually flat, as it has remained during the fiscal years 1994, 1995, 1996, and our 1996 appropriation is some half million dollars less than the program's 1995 appropriations. With our budget the way it is, the coming year will require that the U.S. Trustee Program balance the increase in workload using our depleted resources and traditional role as watchdog in the bankruptcy administration process.

Since its establishment as a nationwide program in 1986, U.S. Trustees have acted in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. It was created to correct longstanding and systemic past abuses in the administration of bankruptcy cases. U.S. Trustees work to assure full and honest disclosure by all parties, prudent administration by trustees and vigilance by creditors.

Charges of cronyism, insider dealings, bankruptcy rings, so commonly heard in the past have disappeared from the vocabulary of bankruptcy reform, and, indeed, those words, those concepts, those situations are not even on the agenda of the current Bankruptcy Review Commission. We submit that the work of the U.S. Trustees has not only been successful, it is essential to the bankruptcy system's integrity and credibility.

There is speculation that this current increase in bankruptcy filings we are now seeing is the result of too much consumer credit card debt, but there is no certainty as to the real cause of the filings. There may, in fact, be many causes. The odd contrast of an expanding economy, low unemployment, and rapidly-increasing bankruptcy filings raises the possibility that a number of these new bankruptcy case filers may be seeking relief that may be undeserved. The U.S. Trustee Program is the first line of defense for the bankruptcy system's integrity, and it will continue to be vigilant in detecting and rooting out fraud and abuse. The program's long-term contribution to the integrity of the bankruptcy process was recognized by the National Academy for Public Administration in their report last year on the U.S. Trustee Program.

Our funding, I understand, is today before the House. We propose to seek to stabilize our resources as far as money and personnel, and to fill some of the financial holes we presently have in that funding. We have requested that chapter 11 quarterly fees be restructured. This proposal we estimate would raise approximately some $13 million in chapter 11 quarterly fees that we feel are critically needed to fund operations of the program. Indeed, the proposal itself is a restatement of the recommendation made by NAPA, National Academy of Public Administration, presented to rationalize the chapter 11 fee structure. If adopted, the new fee structure would finetune the quarterly fee charges by creating additional steps in the fee scale. It would increase fees in the largest cases, but leave unchanged the fees of the smallest cases.

Congress created the U.S. Trustee Program as a self-funding operation. To remain a self-funded system, additional revenues are necessary to support its operation.

We are aware of a proposal currently pending in the Senate that will permit trustees to seek a judicial determination of their fees and expenses.

I would only say one comment about it. As you, Mr. Chairman, have heard——

Mr. GEKAS. You may proceed. We'll give you an extra time here, but I should have said at the beginning that we try to restrict our witnesses to 5 minutes, so that we can expedite the hearings.

Mr. PATCHAN. Thank you, Mr. Chairman. I just want to finish one thought.

As you have stated earlier, the Bankruptcy Commission is at work. This amendment we consider not a technical amendment as it is proposed, but a serious, fundamental change in the foundation of the Bankruptcy Code. We suggest that the matter be first considered by the Commission and then the Congress review of the recommendations of the Commission in that regard.

Thank you for your reception——

Mr. GEKAS. Thank you. Your written statement will be accepted for the record, without objection.

Mr. PATCHAN. Thank you.

[The prepared statement of Mr. Patchan follows:]

PREPARED STATEMENT OF JOSEPH PATCHAN, DIRECTOR, EXECUTIVE OFFICE FOR U.S. TRUSTEES, DEPARTMENT OF JUSTICE

I thank you for this opportunity to make this submission to the Subcommittee. I am joined by Clarkson McDow, United States Trustee for Region IV (South Carolina, Virginia, West Virginia, the District of Columbia, and Maryland), and Scott Michel, United States Trustee for Region XI (Northern Illinois and Wisconsin). Mr. Michel is also serving as Acting United States Trustee for Region III (Pennsylvania, New Jersey, and Delaware). Mr. McDow and Mr. Michel are each submitting statements discussing their experience as United States Trustees

The United States Trustee Program and the bankruptcy system today face a great increase in bankruptcy filings. Over the 12 month period ending March 31, 1986, chapter 7 and chapter 13 filings have increased approximately 17 percent. We are also seeing signs that chapter 11 business filings may increase over the next year. For the first time in our nation's history bankruptcy filings will exceed one million cases.

There is no consensus as to exactly why the number of cases is increasing so dramatically. The phenomenon seems at odds with the overall health of the economy—inflation and unemployment are low, yet bankruptcies are up.

The Program faces this increased workload after several years of austerity. The Program's on-board personnel have been reduced by 145 since September 30, 1992—we now stand at 1050 on-board personnel. Our budget remained virtually flat in fiscal year 1994, 1995, and 1996. Our 1996 appropriation of $ 102,272,000 is half a million dollars less than the Program's 1995 appropriation and—based on traditional budgetary calculations—$4.7 million less than would be needed for the Program to perform the same work as in fiscal year 1995.

The coming year will require that the United States Trustee Program balance this increase in workload with its streamlined resources and its traditional role as "watchdog" of the bankruptcy system. Since its establishment as a nationwide program in 1986, the United States Trustee Program has acted in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. Created to correct long-standing and systemic past abuses in the administration of bankruptcy cases, the United States Trustee Program works to assure full and honest disclosure by all parties, prudent administration by trustees, and vigilance by creditors.

The need for the Program springs from the nature of bankruptcy itself: unlike typical litigation, that involves few parties who directly protect their self-interest,

a bankruptcy case regularly affects many creditors whose small stake in the proceeding or distance from the bankruptcy forum too often gives them little incentive to participate. For these parties with the true economic stake in the bankruptcy case, it commonly takes too much time or costs too much money to serve as watchdogs for their interests.

Vast sums of money—billions of dollars—are at stake in the bankruptcy system. Fraud, embezzlement, insider dealings, excessive compensation of professionals at the expense of creditors, and undue delay, would add to the cost of the system, and threaten to corrupt it.

Before the creation of the Program, the judges were the only watchdogs. To do the job, judges often had to be involved in the administration of the cases before them, to engage in *ex parte* contacts, interview and select trustees, and participate in a host of nonjudicial functions. There were widely reported stories of cronyism, bankruptcy rings, and other scandals that tainted the entire system.

Congress wisely decided to separate the judicial and administrative functions of the bankruptcy process. With these reforms, judges would rule on particular disputes within a bankruptcy case; the United States Trustee would undertake most of the administrative functions, and serve as a buffer to protect the integrity of the judicial process. Judges are now left to judge, and their rulings cannot be questioned on the grounds that they were trying to protect a trustee appointed by them, or were influenced thorough improper contacts. With this system in place, charges of cronyism, insider dealing, and bankruptcy rings—so commonly heard in the past—have largely disappeared from the vocabulary of bankruptcy reform and, indeed, are not even on the agenda of the current Bankruptcy Review Commission..

Our administrative functions are manifold. The U.S. Trustee now appoints private trustees and handles administration. All private trustees undergo FBI background investigations before being appointed. Their books are regularly audited and, if necessary, corrective steps are taken. In extraordinary cases of fraud or misconduct, the U.S. Trustee will actually take over the private trustee's operation, reconstruct the books and records, and "clean up" the operation for delivery to a new trustee. Requests for compensation out of bankruptcy estates are reviewed by the Program and, where necessary, objections are filed and reductions are sought. We monitor the pace of cases through the system to assure delay is minimized. Since the Program was instituted nationwide in 1987, we have helped to substantially decrease the average time it takes to close a chapter 7 or chapter 11 case.

This work by the United States Trustees is essential to the bankruptcy system's integrity and credibility. As the nation's bankruptcy "watchdog," the Program is carefully monitoring the current increase in bankruptcy filings. There is speculation that this increase is the result of too much consumer debt, but no one is certain as to the cause. There may in fact be many causes. The odd juxtaposition of a expanding economy, low unemployment, and rapidly increasing bankruptcy filings raises the possibility that a number of these new debtors may be seeking relief that is undeserved. The United States Trustee Program is the first line of defense of the bankruptcy system's integrity, and it will be vigilant in assuring that fraud and abuse does not contribute to the increase in filings.

OUR CONTRIBUTIONS TO THE BANKRUPTCY SYSTEM OVER THE PAST YEAR

In the past year, the Program has enjoyed many successes. For example:

The Program has increased investigation and detection of bankruptcy fraud. On February 29, Operation Total Disclosure announced 112 indictments for bankruptcy fraud throughout the country, including several against "bankruptcy mills" under the newly enacted provisions of 18 U.S.C. § 156.

The Program has pursued civil enforcement actions and obtained recoveries against petition preparers under the newly enacted provisions of 11 U.S.C. 110.

The Program has improved monitoring and standards for chapter 7 trustees, and has begun to reduce the number and burden of these audits, while maintaining the quality of supervision.

The Program formulated and issued nationwide Professional Fee and Expense Guidelines.

The Program continued its efforts to significantly reduce the number of lingering chapter 11 cases.

In addition to these accomplishments, the Program's long term contribution to the integrity of the bankruptcy process was recognized recently by the National Academy for Public Administration ("NAPA"). According to NAPA, the Program has enhanced the integrity of the bankruptcy system; improved case administration, through improved standards and accountability for private trustees; and recruited a staff of dedicated professionals and established effective management controls.

Also in 1995, the Program fundamentally changed its process for devising and implementing policy: For the first time in its history it publicly invited comments from interested parties outside the Program. An advisory board consisting of judges and United States Trustees was created to review comments and hear presentations on proposed policy changes, and suggest revisions to the Director based on its deliberations. Only after comments are received and considered is a final policy issued. The Program used this process of consultation and revision in drafting the Professional Fee Guidelines and its proposed standards for standing trustees (for chapters 12, for family farmers, and 13, for individuals with regular income).

As this Subcommittee is aware, our proposed standing trustee standards have generated some controversy, and have led to claims that the United States Trustee Program is attempting to "micro-manage" Chapter 13 standing trustees. I want to emphasize, however, that our proposed Standards—which are ethically oriented—attempt only to have chapter 13 operations conducted in a manner consistent with the most basic of fiduciary obligations. Mr. McDow will address some of the problems presented in chapter 13 administration.

We will continue to seek input from the bar and other bankruptcy professionals as we develop policy. We will meet with representatives of interested groups. We will tell them what we are thinking and planning. We will ask them for their views and concerns, and consider those views carefully as we move forward.

THE COMING YEAR

Our fiscal 1997 budget includes the following initiatives:

A Structural Reorganization of the Program. This initiative would implement reorganization of the United States Trustee Program to streamline its operations. Certain reductions of staff can be and are being made without statutory change. Reduction of the number of U.S. Trustees from 21 to 11, and configuration of the regions to match the existing judicial circuits, would require legislative action. The Administration intends to submit the proposal to the Bankruptcy Review Commission. It is recommended that legislation on the number of U.S. Trustee regions await the Commission's consideration and report on the proposal.

One event of this past year that has generated much discussion is the Department's decision, in February, 1996, to certify the United States Trustees as confidential policymaking and policy advocating positions. This was not an attempt to "politicize" the Program, but rather to acknowledge that United States Trustees—like United States Attorneys—are senior level executives.

Chapter 11 Quarterly Fee Restructuring. This proposal to modify the Chapter 11 fee structure, which is based on a recommendation in the NAPA report, would raise an estimated $13.4 million in chapter 11 quarterly fees to fund operations of the Program.

Congress created the United States Trustee Program as a self-funding operation. Currently, approximately two-thirds of the funds for the Program's operations come from chapter 11 filing fees and quarterly assessments. Chapter 11 cases, since the inception of the Program, have carried a heavy proportion of the Program's funding. This dependency becomes a problem when chapter 11 filings decline, for the decline causes a disproportionate decrease in the Program's funding. If enacted, the new fee structure would rationalize the fee scale by creating additional levels. However, the most sizable cases would generally pay more.

Figure 1 is a chart comparing the existing fee structure and the proposed scale. There is not change in the quarterly fee proposed for the smallest cases. To reduce the Program's dependence on Chapter 11 filing fees, a Chapter 13 disbursement assessment had been proposed, but we understand that the House Committee on Appropriations has not included the assessment in the Program's FY 1997 appropriations bill.

Quarterly Disbursements	Current Fee	Proposed
$0 to 14,999	$250	$250
15,000 to 74,999	500	500
75,000 to 149,999	500	750
150,000 to 224,999	1,250	1,250
225,000 to 299,000	1,250	1,500
300,000 to 999,999	3,750	3,750
1,000,000 to 1,999,999	3,750	5,000
2,000,000 to 2,999,999	3,750	7,500
3,000,000 to 4,999,999	5,000	8,000
5,000,000 and up	5,000	10,000

Figure 1 - *COMPARISON OF CURRENT AND FEES PROPOSED QUARTERLY*

Amendment to 28 U.S.C. §586. We are aware of a proposal currently pending in the Senate that will permit chapter 12 and chapter 13 standing trustees seek a judicial determination of their fees and expenses, and that vests in the courts the "exclusive authority to remove [a panel or standing trustee] as to future cases." This proposal is seriously flawed and ill-advised for several reasons, including:

Though denominated a "technical" amendment, it represents a substantive restructuring of the bankruptcy process; as presently drafted, it interjects the bankruptcy court into the administrative process, thereby reversing one of the major reforms of the 1978 Bankruptcy Code.

It encroaches on the Department of Justice's supervisory responsibilities and eviscerates the United States Trustee's ability to appoint and supervise trustees.

This significant change to the structure of the bankruptcy system has not yet been considered by the Bankruptcy Review Commission, created by Congress in 1994 to review matters of such import.

For review of budget issues, the proposal creates conflicting standards, one in title 28 to be applied by the United States Trustee and a separate one under title 11 to be applied by the courts.

De novo judicial review before the bankruptcy court of the United States Trustee's budget decisions will foster litigation.

Eliminates the only administrative tool the United States Trustees have to encourage prompt compliance and cooperation from trustees, and allows even a problem trustee to receive until a judicial determination can be obtained..

Fails to consider numerous unintended consequences.

We currently have a process of handling trustee complaints, that includes appeal and review through the Executive Director. It has not been widely used. We are considering improvements to this process and whether some additional administrative review procedure would be appropriate.

Thank you for the opportunity to testify. I will be pleased to answer any questions you might have.

Mr. GEKAS. Mr. Michel.

STATEMENT OF M. SCOTT MICHEL, U.S. TRUSTEE FOR REGION 11, DEPARTMENT OF JUSTICE

Mr. MICHEL. Thank you, Mr. Chairman.

For the past 10 years, I served as the U.S. Trustee for Region 11, and during this time I've also served 2½ years as the U.S. Trustee for Region 9, which is Ohio and Michigan, and am currently serving as the U.S. Trustee for Region 3, Pennsylvania, New Jersey, and Delaware. Prior to my appointment as a U.S. Trustee in 1987, I was in private practice for 8 years with a large Chicago law firm.

My years with the program began with the nationwide expansion in 1986, and I've seen, and dealt with, transitional problems associated with developing and implementing a new national bankruptcy administrative oversight system. The reasons for its creation and its attendant difficulties of this process have been well documented. From my vantage point, the program has come a long, long way. After the nationwide expansion, the program's primary focus was in the chapter 11 area. This emphasis was a result of the widespread concern reflected by Congress, the judiciary, the credit community, and bankruptcy professionals that there were too many chapter 11 cases pending in the system, and that this number would continue to grow with increased filing levels.

The large backlog of chapter 11 cases gave the program ample opportunity to exercise its newly-created monitoring and administrative functions. Through the U.S. Trustee's involvement in the supervision of chapter 11 cases, the U.S. Trustee was able to identify early on cases which lack the realistic prospect of reorganization and should be converted to chapter 7 or dismissed from the system. These efforts kept the cases from languishing in the system due to creditor inactivity, debtor delay, or judicial inattention. By 1991, as a result of our supervisory efforts, the number of pending chapter 11s had been significantly reduced.

In the chapter 7 area, the early years were dedicated to raising the level of trustee accountability and training trustees to maintain records that could be reviewed and audited. This was an especially daunting task since trustees who practiced under the system prior to our program received limited oversight and operated with few accountability standards. Vast numbers of chapter 7's clogged judicial dockets. Some trustees were not aware of the cases that were assigned to them. Trustee reporting requirements were inconsistent or nonexistent. Trustees were underbonded or not bonded at all. A State's funds were often commingled and were not required to be invested. Cash and checks were sometimes kept in unlocked file cabinets. From a fiduciary perspective, the situation was in complete disarray.

By 1992, the number of chapter 7 filings and the amount of dollars involved reached historic proportions. In addition, an OMB assessment found that the oversight of chapter 7 trustees was a high-risk area. Similarly, a report from the Justice Department's OIG urged the program to strengthen its oversight of private trustees.

As a result, the program developed chapter 7 policies and initiatives, the chapter 7 trustee supervision manual, and updated chapter 7 handbook. These new policies reflected the need for closer supervision of case trustees with a focus on closing those cases open longer than 3 years, which were termed "old"; increasing the return of estate assets to creditors, and initiating remedial actions against trustees who breached their fiduciary duties.

In 1995 the program assessed the success of the initiative and concluded that trustee accountability, professionalism, and commitment to maximizing return to creditors had substantially increased. Overall reduction in the number and degree of critical audit findings demonstrated that trustees had improved internal financial controls and case administrative practices. The number of old chapters 7 cases had been substantially reduced, and the percentage of funds returned to creditors had increased. This assessment was supported by NAPA in 1995, which, like the GAO before it, concluded that the program had enhanced the integrity of the bankruptcy system and improved case administration.

In addition to our successes in the chapter 7 and 11 areas, the program's efforts in the criminal referral area has also contributed to the overall improvement of the bankruptcy system. My first experience with bankruptcy fraud came just 2 months into my term as the U.S. Trustee, when my office discovered that a chapter 7 panel trustee had embezzled almost $2 million from 117 chapter 7 cases. At the time it was the largest trustee defalcation on record, and it made a lasting impression on me. It prompted a complete reassessment and reevaluation of our trustee supervision and monitoring procedures. Those changes are now an integral part of our overall chapter 7 oversight scheme.

Since then, the program has discovered other trustee embezzlements, as well as debtor and professional fraud. In fact, during the past 5 years the program has made more than 2,300 debtor or trustee criminal referrals, resulting in almost 400 convictions. In the last 3 years alone, 19 trustees and 5 trustee employees have been convicted for embezzling over $6.5 million and sentenced to a total of 17 years.

The program's efforts to detect bankruptcy fraud and to assist the U.S. Attorneys in their investigations is time-consuming and resource-intensive. However, as the program has evolved, efficiencies have been developed in this process, most notably the creation of local bankruptcy fraud task forces which are comprised of representatives from the U.S. Trustee's Office, the U.S. Attorney's Office, the FBI, the IRS, and the postal inspectors.

By way of example, our Attorney General, along with the U.S. Attorney and the FBI, jointly announced a separate, multi-count indictment resulting from a major undercover operation known as "Churn and Burn." The targets of this investigation were bankruptcy petition preparers who had defrauded 100 consumer debtors of approximately $100,000 due to filing of fraudulent bankruptcy cases.

The program is also actively involved in the national law enforcement "Operation Total Disclosure," announced by the Attorney General early this year.

All in all, the last 10 years have been challenging, exciting, and rewarding. Being able to contribute to the significant improvements in bankruptcy administration has been very satisfying, but much remains to be done. Improvements can always be made. The program began with a far-reaching mandate and has made enormous progress in fulfilling the congressional intent, and I believe we're doing our job and we're doing it well.

I thank you, Mr. Chairman, for your time and apologize for going over.

Mr. GEKAS. Your statement as well will be accepted for the record, without objection. That holds true for every witness, but from time to time, having forgotten what I did yesterday, I'll repeat that message.

[The prepared statement of Mr. Michel follows:]

PREPARED STATEMENT OF M. SCOTT MICHEL, U.S. TRUSTEE FOR REGION 11, DEPARTMENT OF JUSTICE

Thank you Mr. Chairman and members of the Subcommittee for allowing me to testify as to some of my observations and experiences as a United States Trustee.

For the last 10 years I have served as the U. S. Trustee for Region 11 (Northern District of Illinois, State of Wisconsin). During this time I have also served 2½ years as the U.S. Trustee for Region 9 (Ohio, Michigan) and am currently serving as U.S. Trustee for Region 3 (Pennsylvania, New Jersey, Delaware). Prior to my appointment as a U.S. Trustee in 1987 I was in private practice for 8 years with a large Chicago law firm.

My years with the Program began with the nationwide expansion in 1986. I have seen and dealt with the transitional problems associated with developing and implementing a new national bankruptcy administrative oversight system. The reasons for its creation and the attendant difficulties of this process have been well documented. From my vantage point the Program has come a long, long way.

After the nationwide expansion, the Program's primary focus was in the Chapter 11 area. This emphasis was a result of the widespread concern reflected by Congress, the Judiciary, the credit community, and bankruptcy professionals that there were too many chapter 11 cases pending in the system, and that this number would continue to grow with the increased filing levels. The large backlog of chapter 11 cases gave the Program ample opportunity to exercise its newly created monitoring and administrative functions. Through the United States Trustee's involvement in the supervision of chapter 11 cases, including the meeting of the twenty largest creditors, the section 341 creditor's meeting, the appointment of creditor committees, and the review of professional employment applications and cash collateral orders, the U.S. Trustee was able to identify early on cases which lacked a realistic prospect of reorganization and should be converted to chapter 7 or dismissed from the system. These efforts kept cases from languishing in the system due to creditor inactivity, debtor delay, or judicial inattention. By 1991, as a result of our supervisory efforts, the number of pending chapter 11 cases had been significantly reduced.

In the Chapter 7 area, the early years were dedicated to raising the level of trustee accountability and training trustees to maintain records that could be reviewed and audited. This was an especially daunting task since trustees who practiced under the system prior to the U.S. Trustee received limited oversight and operated with few accountability standards. Vast numbers of chapter 7 cases clogged judicial dockets. Some trustees were not aware of cases assigned to them. Trustee reporting requirements were inconsistent or non existent. Trustees were under bonded or not bonded at all. Estate funds were often commingled and were not required to be invested. Cash and checks were kept in unlocked file cabinets. From a fiduciary perspective, the situation was in complete disarray.

By 1992, the number of chapter 7 filings and the amount of dollars involved reached historic levels. In addition, an OMB assessment found that the oversight of chapter 7 trustees was a "high risk area." Similarly, a report from the Justice Department's OIG urged the Program to strengthen its oversight of private trustees.

As a result, the Program developed Chapter 7 Policies and Initiatives, the Chapter 7 Trustee Supervision Manual, and an updated Chapter 7 Handbook. The new policies reflected the need for closer supervision of case trustees with a focus on closing "old" cases (cases open longer than three years), increasing the return of estate assets to creditors, and initiating remedial actions against trustees who breach their fiduciary duties. Program staff assumed greater responsibilities for reviewing trustee financial reports, personally following up on audit reports, ensuring that old cases were closed, and initiating appropriate legal action against trustees and debtors who did not comply with the law.

In 1995, the Program assessed the success of the initiatives and concluded that trustee accountability, professionalism and commitment to maximizing return to creditors had substantially increased. Overall reduction in the number and degree of critical audit findings demonstrated that trustees had improved internal financial

controls and case administration practices. The number of old chapter 7 cases had been substantially reduced and the percentage of funds returned to creditors had increased. This assessment was supported by the National Academy of Public Administration (NAPA) in May 1995, which like the GAO before it, concluded that the Program had enhanced the integrity of the bankruptcy system and improved case administration.

In addition to our successes in the chapter 7 and 11 areas, the Program's efforts in the criminal referral area has also contributed to the overall improvement of the bankruptcy system. This was an area also cited favorably by NAPA and the GAO.

My first experience with bankruptcy fraud came just two months into my term as U.S. Trustee when my office discovered that a Chapter 7 panel trustee had embezzled almost $2 million from 117 Chapter 7 cases. At the time, it was the largest trustee defalcation on record and it made a lasting impression on me. It prompted a complete reassessment and reevaluation of our trustee supervision and monitoring procedures. Those changes are now an integral part of our overall Chapter 7 oversight scheme.

Since then the Program has discovered other trustee embezzlements as well as debtor and professional fraud. In fact during the past five years the Program has made more than 2,300 debtor or trustee criminal referrals resulting in almost 400 convictions. In the last three years alone, 19 trustees and five trustee employees have been convicted for embezzling over $6.5 million dollars and sentenced to a total of 17 years.

The Program's efforts to detect bankruptcy fraud and to assist the U.S. Attorneys in their investigations is time consuming and resource intensive. As the Program has evolved, however, efficiencies have been developed in this process, most notably the creation of local bankruptcy fraud task forces comprised of representatives from the UST, U.S.A., F.B.I., IRS, and Postal Inspectors. These task forces have greatly improved the investigation and prosecution of bankruptcy fraud and bankruptcy related crimes. The relationship between my office and the United States Attorney's Office in Chicago has been mutually beneficial and productive.

By way of example, on May 18, 1995, the Associate Attorney General, along with the United States Attorney, the FBI and myself, jointly announced seven separate multi-count indictments resulting from a major undercover operation known as Churn-N-Burn. The targets of that investigation were bankruptcy petition preparers who defrauded over a hundred consumer debtors of approximately $100,000 through the filing of fraudulent bankruptcy cases. The victims included individuals about to lose their homes, consumers in financial difficulty, and creditors seeking to collect legitimate debts. The indictments were the first in the country brought under 18 U.S.C. § 157, which was enacted in October, 1994, and prohibits any scheme to defraud in which the perpetrator uses the bankruptcy system to further fraud.

The Program is also actively involved in the nationwide law enforcement effort, "Operation Total Disclosure" announced by the Attorney General earlier this year. The "Operation" was aimed at prosecuting people who abuse the bankruptcy system and was the result of a multi-agency effort involving the United States Trustee Program, United States Attorneys, the FBI, the Criminal & Tax Divisions of the Department of Justice in close coordination and participation with the IRS and the Postal Inspection Service.

All in all the last ten years have been challenging, exciting and rewarding. Being able to contribute to the significant improvements in bankruptcy administration has been very satisfying. But much remains to be done. Improvements can always be made. The UST Program began with a far reaching mandate and has made enormous progress in fulfilling Congressional intent. We're doing our job and we're doing it well.

Mr. Chairman and members of the Committee, I appreciate the interest shown and the time you have given, and again thank you for the opportunity to share these thoughts with you.

Mr. GEKAS. Mr. McDow.

STATEMENT OF W. CLARKSON McDOW, JR., U.S. TRUSTEE FOR REGION 4, DEPARTMENT OF JUSTICE

Mr. McDOW. Thank you, Mr. Chairman.

I am the U.S. Trustee for Region 4. My region includes the States of Maryland, South Carolina, Virginia, West Virginia, and the District of Columbia. I appreciate the opportunity to be here

today, and my testimony will concentrate on the U.S. Trustee's role in chapter 13.

I've been a U.S. Trustee for more than 2 years. For 23 years before that, I practiced law. As a lawyer, I found that chapter 13 was a rewarding area in which to practice. In the typical chapter 13, the wage-earner is able to file a plan with the bankruptcy court whereby the wage-earner can pay part of his or her income to a standing trustee. The standing trustee then makes payments to creditors, as provided by the plan. The debtor is able to prevent the foreclosure of his or her house. The mortgage gets cured. Unsecured creditors are paid at least part, if not all, of the debts. Everyone wins.

Good, competent trustees help in the process. I was proud to participate in this process as an attorney representing hundreds of debtors, and I'm proud of the role that the U.S. Trustee plays in chapter 13 today.

The United States Code imposes on the U.S. Trustee the duties of appointing and supervising standing trustees who serve in chapter 13 cases. We also review the trustee's proposed budget to determine the trustee's actual necessary expenses, and, based on this budget, set the amount that the trustee can deduct from planned payments to apply to these expenses. Unfortunately, this budget review process sometimes generates complaints of micromanagement.

The U.S. Trustee's role in chapter 13 extends beyond budget review. My written statement sets forth some of the ways my region participates in chapter 13 administration.

What have I learned about chapter 13 in my short tenure as U.S. Trustee? First, standing trustees are not private enterprises facing the market risk inherent to private businesses. They have a monopoly on the cases filed in the assigned geographic area. There's no competition.

Second, the natural market forces are not operating. Unlike private businesses in which each dollar spent comes from the owner's pocket, each dollar spent by standing trustees comes from the pocket of either the creditors or debtors.

Third, being a standing trustee can be a lucrative position. Many of the standing trustees, in addition to receiving maximum compensation of $125,000, directly or indirectly benefit from their expenses by salaries paid to relatives or by rent paid to themselves or family members. The U.S. Trustees are in the process of adopting standards which address some of these practices.

While the standing trustee's compensation is capped at $125,000, several trustees in Region 4, when family income and insider rental payments are included, receive in excess of $175,000 per year. While not all of the cries of micromanagement arise from the denial of increases of payments to insiders, a large number do.

Fourth, I've learned that the budget decisions can be difficult and even painful. Holding the line on expenditures, whether by Congress or a U.S. Trustee reviewing a standing trustee's budget, is a difficult and sometimes lonely calling.

Finally, I've learned that there are solid reasons for maintaining the separation of the court's judicial function from the administrative functions of supervision and budget review. The worst thing

that could happen to chapter 13 would be for the budget process to become an adversary proceeding decided by the courts. The courts are wonderful institutions, but they are not the answer to all of our problems.

Proposed legislation that would provide for the bankruptcy courts to determine the standing trustee's actual and necessary expenses, and give the bankruptcy courts the exclusive power to remove a trustee as to future cases, would be disastrous for the bankruptcy system. Not only would this legislation return the court to the administrative functions, it would leave the U.S. Trustee with the responsibility of appointing and supervising the trustee and the court deciding the budget and determining whether the trustee continues to receive cases. The U.S. Trustee would have the duties and the responsibilities, but none of the authority.

In conclusion, much good occurs in chapter 13. Houses are saved from foreclosures. Debts are repaid. Lives are restored. The trustees deserve much credit for a job well done. However, both the standing trustees and the bankruptcy system benefit from the checks and balances provided by the U.S. Trustee. The U.S. Trustees believe that chapter 13 can further benefit from meaningful, good-faith dialog between the U.S. Trustees and the standing trustees.

Thank you for your time and interest in the U.S. Trustee Program. I'd be glad to answer any questions you might have.

[The prepared statement of Mr. McDow follows:]

PREPARED STATEMENT OF W. CLARKSON MCDOW, JR., U.S. TRUSTEE FOR REGION 4, DEPARTMENT OF JUSTICE

Mr. Chairman, Members of the Subcommittee on Commercial and Administrative law, as the United States Trustee for Region Four, consisting of the states of Maryland, South Carolina, Virginia, West Virginia, and the District of Columbia, I appreciate the opportunity to testify about the role of the United States Trustee in the bankruptcy process.

By way of background, I have been a United States Trustee for slightly more than two years. For 23 years before that, I was a lawyer in Rock Hill, South Carolina. My practice involved commercial law and bankruptcy. Much of my practice involved chapter 13, and I represented both debtors and creditors. As a lawyer, I found that chapter 13 was a rewarding area in which to practice. Unlike most litigation and other bankruptcy chapters, chapter 13 offers ready opportunities for "win-win" situations. In a typical chapter 13, a wage earner is able to file a plan with the bankruptcy court whereby the wage earner can pay part of his or her income to a standing trustee. The standing trustee then makes payments to creditors as provided by the plan. The debtor is able to prevent the foreclosure of his or her house, the mortgage gets cured, unsecured creditors are paid at least part, if not all, of their debts. Everyone wins. Good, competent trustees help in the process and everyone involved benefits. I was proud to participate in this process as an attorney representing hundreds of debtors, and I am proud of the role that the United States Trustee plays in chapter 13 today.

The duties of United States Trustee are set out in the United States Code at 28 U.S.C. § 586. These duties include the duty to appoint one or more individuals to serve as standing trustee in chapter 12 and chapter 13 cases, and the duty to supervise any individual appointed as standing trustee in the performance of the duties of the standing trustee. Under Title 28 section 586(e)(1), the Director sets the compensation of standing trustees. The maximum compensation is now set at about $125,000. More than 85% of the 169 standing trustees nationwide receive the maximum allowable compensation of $125,000.00.

The salary and expenses of the standing trustee are paid from a percentage of the plan payments made by the debtors, and, after deduction of this percentage, the balance of the payments is paid to creditors. The bankruptcy code allows the Attorney General, after consultation with the United States Trustee, to set the percentage fee of the standing trustee not to exceed 10% of plan payments. The majority

of standing trustees do not need the full 10% to pay their compensation and expenses, therefore less than 10% is generally deducted from the plan payments by the standing trustee.[1] Many attorneys, creditors, and debtors do not understand that most standing trustees receive less than 10% of plan payments. In FY 95 the standing trustees received $104,008,659. in percentage fees and, if they had all received the maximum of 10% they would have received $170,925,788. The total savings for debtors and creditors from these reduced percentage fees was over $66 million. The 15 standing trustees in Region Four received percentage fees of anywhere from 4% to 10%. This variance is mostly a result of case load size, the relative income of the chapter 13 debtors and other similar factors. However, some standing trustees run a more cost conscious operation and this fiscal restraint also contributes to the lower percentage fee. Each dollar not spent by standing trustees for expenses is either paid to creditors or returned to debtors.

Before the nationwide expansion of the United States Trustee Program in 1986, the judges performed the administrative role of approving the budgets of the standing trustees and setting the percentage fee. This was one of the administrative functions Congress shifted to the United States Trustees to separate the administrative and judicial functions of bankruptcy. This separation eliminated the inherent conflict arising from the judges being responsible for both the administrative and judicial functions.

The United States Trustee recommends to the Director of the Executive Office for United States Trustees (EOUST) the percentage fee, based on the actual, necessary expenses of the standing trustee. This process begins with the submission by the standing trustee of a proposed budget for the upcoming fiscal year. The United States Trustee reviews the proposed budget and then submits it to the Director of the EOUST with a recommendation. Informal discussions usually take place between the United States trustee and the standing trustee to resolve any budget questions before the budget is forwarded to the Director. After receiving the budget and the U.S. Trustee's recommendation, the Director issues an order allowing the standing trustee a percentage fee for expenses and sets the standing trustee's compensation. This order is sometimes referred to as a "comp order." This budget review process sometimes generates complaints by the standing trustees of "micro-management."

The standing trustee's budget includes all expenses of the trustee in carrying out his or her duties, including employee salaries, employee benefits, rent, utilities, accounting services, computer services, supplies, consulting services, telephone, postage, training, travel, equipment, and the standing trustees compensation. For FY 96 the average standing trustee's budget included operating expenses of $633,260 in addition to the trustee's compensation.[2]

The seven judicial districts within Region Four are served by 15 standing trustees. They have existing case loads ranging from 476 cases to 5,500 cases. The standing trustees in Region Four have annual disbursements ranging from a low of $1.8 million to a high of $18.5 million. Their operating expenses for FY 95, excluding their compensation, varied from a modest $74,259 to a high of $820,366. Thirteen of the standing trustees within Region Four receive maximum compensation of $125,000.00.

What have I learned about chapter 13 in my short tenure as United States Trustee?

First, standing trustees are not private enterprises facing the market risks inherent to private business. They have a monopoly on the cases filed in their assigned geographic area.

Second, the natural market does not regulate the expenses of chapter 13 trustees, and unlike private business in which each dollar spent comes from the owner's pocket, each dollar spent by standing trustees comes from the pocket of either the creditors or the debtors. The market does not force them to economize because almost all standing trustees are at maximum compensation with no real danger of falling below maximum compensation.[3]

Third, being a standing trustee can be a lucrative position. Many of the standing trustees, in addition to receiving maximum compensation of $125,000, directly or indirectly benefit from their expenses by salaries paid to relatives or by rent paid to themselves or family members. (This practice pre-dates the United States Trustee

---

[1] For FY 95 the audited reports indicate that only 27 of 169 standing trustees received a percentage fee of 10%. The other standing trustees received percentage fees from 3.04% to 9.98%.

[2] In FY 95 the average standing trustee received trust funds of over $12 million.

[3] Every standing trustee with a caseload of over 1125 is at maximum compensation of $125,000. Some standing trustees are at maximum compensation with less than 500 cases, which is less than one-sixth of the average caseload of 3,161 for FY 96.

System and has not been expanded during my tenure. The United States Trustees are in the process of adopting standards to address some of these practices.) Because the United States Trustee cannot count on the standing trustees' normal business judgment when this self-interest is involved, the United States Trustee is required to give these transactions greater scrutiny than others. While the standing trustees' compensation is capped at $125,000, several trustees in Region Four, when family income and insider rental payments are included, receive in excess of $175,000 per year. In other regions the total paid to the standing trustees and relatives is much more. Numerous standing trustees continue to earn additional income from the practice of law and other outside sources. While not all cries of "micro-management" arise from the denial of increases of payments to insiders, a large number do.

Fourth, I have learned that budget decisions can be difficult and even painful. Spending money, especially someone else's money, is always easier than saving money. Saying no is more difficult than saying yes. Holding the line on expenditures, whether by Congress or a United States Trustee reviewing a standing trustee's budget, is a difficult and sometimes lonely calling.

Finally, I have learned that there are solid reasons for maintaining the separation of the court's judicial function from the administrative functions of supervision and budget review. The worst thing that could happen to chapter 13 would be for the budget process to become an adversary proceeding decided by the courts. The courts are wonderful institutions, but they are not the answer to all our problems. Administrative decisions should be made in a nonjudicial setting. Proposed legislation that would provide for the bankruptcy courts to determine a standing trustee's actual and necessary expenses and give the bankruptcy courts the exclusive power to remove a trustee as to future cases would be disastrous for the bankruptcy system. Not only would it return the court to the administrative functions, it would leave the U.S. Trustee with the responsibility of appointing and supervising a standing trustee and the court deciding the budget and determining whether the trustee continues to receive cases. The U.S. Trustee would have the duties and the responsibilities, but none of the authority. Not only would going back to court administration of trustees be inefficient, it would strain the capacity of the courts to decide the budgets of each of 169 standing trustees.[4]

The United States Trustees' role in chapter 13 extends beyond budget review. In my region the United States Trustee has objected to excessive attorney fees charged by debtors' attorneys; moved for dismissal for repetitive and bad-faith filings; encouraged trustees to be more responsive to creditors' requests for information; required periodic reports to creditors and debtors of payments received and disbursements made; monitored the cases of standing trustees to ensure that the cases were promptly administered; monitored trustees to ensure that disbursements are made promptly; encouraged standing trustees to move from hand-made ledger entries to computers; reviewed all trustee bank accounts each month to ensure adequate bonding; placed bids for blanket bonds for standing trustees (realizing a savings of approximately $32,000 per year by reducing the bond from $1.50 per $1,000 to $0.50 per $1,000); met with the standing trustees to discuss ways to improve chapter 13 case administration; required a standing trustee to repay trust funds expended for expensive meals and lodging for friends and family for a side trip taken while attending a training seminar; ensured that a standing trustee's employee who allowed a relative to misappropriate trust funds was not allowed to remain as an employee of the trustee; and, performed annual evaluations of each chapter 13 trustee. In several regions the U.S. Trustee has served as standing trustee without compensation following the death, resignation or removal of the standing trustee.

Much good occurs in chapter 13. Houses are saved from foreclosure, debts are repaid, lives are restored. The trustees deserve much credit for a job well done. However, both the standing trustees and the bankruptcy system benefit from the checks and balances provided by the United States Trustee. The United States Trustees believe that chapter 13 can further benefit from meaningful, good faith dialogue between the U.S. Trustees and the standing trustees.

Thank you for your time and interest in the United States Trustee Program.

Mr. GEKAS. Yes, right off the bat, since you're the last witness on this panel, you stated in your points what you have learned as a U.S. Trustee, your concerns about the $125,000 cap on compensa-

[4]Many standing trustees have cases before more than one judge, and sometimes the standing trustee serves in more than one judicial district. For example, the same standing trustee serves in the Southern District of West Virginia and the Northern District, but has only one staff and one budget. Which judge would decide the budget issues?

tion. You say you're awaiting a report on how to regulate that or how to assess that? Did you say that you're waiting—that there's a task force——

Mr. McDow. No.

Mr. GEKAS [continuing]. Or a committee or——

Mr. McDow. No, sir. What we have, the U.S. Trustees have proposed standards which are now being published that would regulate some of those practices whereby standing trustees hire relatives and also where they rent from themselves, and that sort of situation. Those are the standards that have——

Mr. GEKAS. Are those standards already set?

Mr. McDow. The standards are in the process of being set. They are being——

Mr. GEKAS. Yes, and who's doing that? That's what I'm asking.

Mr. McDow. They would be issued by the Attorney General, and I believe the Attorney General has delegated the authority to Mr. Patchan to publish those.

Mr. PATCHAN. Mr. Chairman, may I interpose?

Mr. GEKAS. Yes. Yes, certainly.

Mr. PATCHAN. About a year-and-a-half ago—well, no, it was about a year ago, I think it was—we published proposed standards—these are ethically-oriented matters such as hiring of relatives, and so on—and set it out for comment. Over the past year we received comments. I set up a board of bankruptcy judges and U.S. Trustees to review those comments, invited representatives of various trustee groups in to make oral presentations to that board.

As a result of that comment period and the recommendations of the board, we reissued and trimmed back many of those standards. They are now being published in the Federal Register. When we reissued it, which was about 2 or 3 months ago, I again invited comments, received some comments. The Federal Register publication has already been made as of a few days ago, and there's another 60-day period for comments, after which this advisory board again will review those comments. And after that effort, we will then put them into effect.

Mr. GEKAS. We're talking about at the end of this year then?

Mr. PATCHAN. Well——

Mr. GEKAS. Or later?

Mr. PATCHAN. November, yes; the end of the year. I think that's right. They are not in effect at the present.

Mr. GEKAS. That's the impression that I got from the statements of Mr. McDow, that we're in the process of——

Mr. PATCHAN. We're in that process.

Mr. GEKAS [continuing]. Promulgating, as it were.

Mr. PATCHAN. That's exactly right.

Mr. GEKAS. Mr. Michel, I noted in your testimony your report on the criminal referrals, and you said that in recent times there was a series of actions, in cooperation with the Postal Service and others, that netted some 400 convictions.

Mr. MICHEL. Yes.

Mr. GEKAS. Can you give me an example of how these people that file or promote the filing of bankruptcy fraudulently—how does that work? How do they get somebody to file a fraudulent bankruptcy filing?

Mr. MICHEL. Sometimes, Mr. Chairman, they didn't—for instance, in the example that I cite in my testimony, on the "Churn-N-Burn," the petition preparers——

Mr. GEKAS. Yes.

Mr. MICHEL [continuing]. They had preyed upon homeowners who were about to lose their homes through foreclosure, and would contact them, either directly—and tell them that they could take care of it; they would deal directly with the lending institution. And in some cases, extreme cases, they had the homeowners sign over titles to their homes, with the expectation that these people would deal with the mortgage companies and pay their mortgages, and then, in fact, they even directed the homeowners to make their mortgage payments to them. Of course, they didn't make it to the banks.

And they went and filed bankruptcy petitions on behalf of the homeowners which stayed possible foreclosures. The homeowners were satisfied, not being very familiar with the bankruptcy process. Once the automatic stay was put in, the houses were not in foreclosure, and they thought they were getting some action. Of course, nothing else happened, and the funds were lost and their houses—then the bankruptcy was dismissed and the foreclosure came back, and they were—it was just a big scam.

Mr. GEKAS. So the fraud portion of that was not in the filing of the bankruptcy, but in the——

Mr. MICHEL. Well, it was in the sense of using the bankruptcy—filing the petition to further a fraudulent scheme, which was noteworthy in this "Churn-N-Burn" because it had the first indictments under the new statute, section 157, which made it a crime to perpetrate a fraud in the bankruptcy process.

Mr. GEKAS. I think those things are important, especially in view of what I felt is one of the key features of bankruptcy, to allow the public to have confidence in its working well. When we have these kinds of things, it works against us.

You're talking about 400 convictions in that one arena?

Mr. MICHEL. Yes, for debtor and trustee criminal referrals. Of the referrals, there were 400 convictions. And, of course, while that number, if you statistically put it against the number of cases or the number of trustees, and over the time period may seem small, the impact is very significant. When I started, there were very little, if any, attention given to bankruptcy fraud and bankruptcy-related crime. And I think that the criminal referral process is an area where, clearly, the U.S. Trustee Program, the achievement is monumental in terms of——

Mr. GEKAS. What's a typical red flag that causes the referral to the criminal side of the judicial system?

Mr. MICHEL. Well, it occurs in different situations. A creditor may call our office or call somebody and say that a debtor has not disclosed all of his assets or an ex-spouse may call about, if they're going through a divorce and it's in bankruptcy, may call about other assets that have been concealed or transferred. We get numerous pieces of information from creditors, other interested parties in the system, and that's where we rely heavily.

And, of course, our chapter 7 trustees that conduct the 341 meetings, the initial meeting of creditors in a chapter 7 case, are also

attentive to any kind of abnormalities or irregularities in those meetings, first meetings with creditors. And they ask the creditors whether all their assets have been disclosed, and if there's something that's just not right, they will pursue it, and that's one of the reasons getting high-quality chapter 7 trustees is so important to the system and to preventing bankruptcy fraud.

Mr. GEKAS. And the uniform referral would be to the U.S. Attorney; is that correct?

Mr. MICHEL. Yes, and that comes from—bankruptcy judges, too, make referrals to the U.S. Attorneys, and we coordinate—the U.S. Trustee's Offices around the country have set up these bankruptcy fraud task forces which have proved to be very productive and beneficial for both the U.S. Attorneys' offices and our office in terms of investigating and prosecuting a bankruptcy fraud.

Mr. PATCHAN. Mr. Chairman, could I supplement——

Mr. GEKAS. Yes, you may.

Mr. PATCHAN [continuing]. Mr. Michel's comments?

We have, in addition, a member, an Assistant U.S. Trustee who was a U.S. Attorney, and he devotes his full time to training courses, to meeting with U.S. Attorneys, meeting with FBI people, and working with them in developing cases, and sometimes in developing the indictment, in making certain that the file is complete, so that they don't have to learn how to handle what may be a different area of the law for some of them, white collar crime and bankruptcy crime, in particular. We spend a lot of time and effort with this person and with other assistants in our program who train people how to be alert to, among other things, and how to respond to what Mr. Michel has mentioned, the "ex-file," which is one of the great sources of our beginning of investigation. That is the ex-spouse, the ex-partner, the ex-creditor, who may have some information which we follow up.

And one of our successes has been in working out task groups with the FBI, with other law enforcement people, with U.S. Attorneys, to follow up on the references made by judges, made by trustees, made by our office, to see where they are, to see if they need more information or need more help, or to learn that maybe there isn't enough to go forward.

Some of our cases get lost in other statistics. Very often the U.S. Attorney may opt to follow up a tax prosecution, which may have started as a bankruptcy matter. Too often the bankruptcy fraud, the same individual who has committed bankruptcy fraud has probably committed other crimes, and that's what they do turn up.

Mr. GEKAS. In conjunction with that, do we have a similar pattern of referrals to disciplinary boards or to the courts of attorneys who may have been complicit in some of these fraud cases or have tacitly permitted their clients to engage in these kinds of activities? Is there a high incidence of it or not?

Mr. PATCHAN. On occasion we will, but usually it follows a conviction. Once we do get a conviction, that would ordinarily follow in the normal course, but on occasion we have made references to bar associations in certain States.

Mr. GEKAS. Your title is what now, Mr. Patchan, exactly?

Mr. PATCHAN. Director of the Executive Office for U.S. Trustees.

Mr. GEKAS. And how did you acquire that position? How did you get to that position? You were appointed by whom?

Mr. PATCHAN. The Attorney General.

Mr. GEKAS. That brings my next point: would your job, the job of Director, be enhanced if your position was elevated to being an Assistant Attorney General?

Mr. PATCHAN. Well, I think I'd make more money, for one thing. [Laughter.]

Mr. GEKAS. Yes, I was thinking of your pension. [Laughter.]

Mr. PATCHAN. I get——

Mr. GEKAS. We get the general picture that there are problems in managing the regional trustees, and we get reports from various levels to that effect. We're wondering if we should change the configuration of the control mechanism by having your position be that of an Assistant Attorney General, thus giving a little more aegis of power, shall we say.

Mr. PATCHAN. Well, the way we govern the program is through committees of trustees. We have a series of committees, one devoted, say, to chapter 7, another one to chapter 11, another to chapter 13, and we seek consensus on establishing national policy. However, we do—the regional trustees do have policymaking, policy-determining authority for matters within their own region. We have honored the local legal culture, which is a feature of bankruptcy law application. Certain areas, certain States, certain districts have particular procedures, and this does call for adapting even national policies to local situations.

Mr. GEKAS. Well, what you're describing is—I believe a fair implication of that is that there's a disparity region-to-region, locality-to-locality, as to how standards are applied.

Mr. PATCHAN. In some matters there are, and the intent is to fit the local situation, similar to U.S. Attorneys who have particular procedures in a special area.

Mr. GEKAS. Our whole effort on sentencing guidelines on the criminal side was to try to reduce or eliminate disparity of actions on the part of the various judges across the Nation. If creating a position of Assistant Attorney General would help to reduce disparity, would you think that it's worthy of consideration?

Mr. PATCHAN. Well——

Mr. GEKAS. Or don't think you think it would help——

Mr. PATCHAN. I don't think you have to change the title, but the——

Mr. GEKAS. No, no, but we'd give a concomitant set of powers, though, to that individual. You don't think there's any value in that?

Mr. PATCHAN. Well, there are times I would certainly like to be able to dictate rather than ask, I must say. [Laughter.]

But I still think, no matter what structure we come up with, certainly there could be a stronger centralization to a degree, but whatever structure we come up still has to honor, as I characterize it, the local legal culture.

Mr. GEKAS. Well, I thank the gentlemen of the first panel, and you're excused with our thanks. You're welcome to stay to listen to some of your colleagues or to take lunch or to visit the Capitol, whatever you wish.

Mr. PATCHAN. Thank you very much, Mr. Chairman.
Mr. GEKAS. Thank you very much.
Mr. MICHEL. Thank you, Mr. Chairman.
Mr. McDOW. Thank you.

Mr. GEKAS. The next panel will be now introduced and invited to be seated at the panel table. Henry E. Hildebrand III, legislative chairman and former president of the National Association of Bankruptcy Attorneys, he's also the chapter 13 standing trustee for the Middle District of Tennessee.

Lawrence P. Morin is the president of the Association of Bankruptcy Professionals and is a chapter 13 standing trustee in Lynchburg, VA.

Jeffry M. Freedman is vice president of the National Association of Consumer Bankruptcy Attorneys. He has served as a chapter 7 trustee for 7 years.

David Ray practices law in Los Angeles, CA, and represents the National Association of Bankruptcy Trustees.

We welcome you, and we will begin the testimony in the order in which you were introduced. And I will repeat the observation that your written statements will become a part of the record, without objection, and you will be limited to a more or less 5-minute period.

Mr. Hildebrand.

STATEMENT OF HENRY E. HILDEBRAND III, CHAPTER 13 TRUSTEE, U.S. BANKRUPTCY COURT FOR THE MIDDLE DISTRICT OF TENNESSEE

Mr. HILDEBRAND. Mr. Chairman, I've listened to the first panel. I've read through some of the testimony that I've gotten and there's a lot of thought that has gone into the issues before the committee. I appreciate the interest that the committee has in this process.

I want the committee to remember, though, what the whole focus of this system. I remember back to what I was doing 24 hours ago today. Yesterday I presided at meetings of creditors in Nashville, TN. There were 48 separate cases which involved older couples, younger couples, sole proprietors operating a business, the medically-unfit, individuals who were forgotten, divorced people, people who owed funds to creditors local banks, national banks, regional banks.

They owed money on mortgages. They owed money to hospitals and doctors. These people sought to save their homes. They sought to save a car, which in many of the cases was the most important thing in their lives. They sought to salvage the only assets they owned: their car, their house, their furniture. Many of them sought to restore the dignity that they had felt by being able to repay their debts.

These cases that I saw yesterday now force me to color my remarks today. It is: how can the process best work to help the people who are there trying to pay their debts back through chapter 13, and the creditors who are receiving a substantial dividend as a result of this operation?

As I said in my written testimony, one of the functions of a trustee is to act as a fiduciary. I'm committed and I'm dedicated to fulfilling my responsibility as fudiciary, and I would dispute any com-

ments that said that there's no control over the trustee, no outside supervision. I heard Mr. McDow say that there is no outside market force that controls us. That somewhat, I think, misses the point.

A trustee is a fiduciary. A trustee is a fiduciary just as a probate executor is, as a testamentary administrator is. And, as such, the trustee is held to a higher standard of conduct. As a trustee, I am accountable. And, as fiduciary, I'm accountable to the debtors I'm accountable to the creditors I'm accountable to the court. The court that I'm accountable to is the U.S. Bankruptcy Court in which I serve as trustee.

The bankruptcy court has always been empowered to make certain decisions involving the administration of cases that were committed to its jurisdiction. The bankruptcy court was removed from the pure administration of bankruptcy cases when it was decided that judges should be judges, that bankruptcy judges should resolve disputes that come before them. I applaud that decision. I think that was a good idea back in 1979. I think it's still a good idea. Bankruptcy judges should not administer; they should resolve disputes.

What's before the Senate, what's been talked about today, appears to me to be an avenue where a bankruptcy judge can resolve disputes, and such disputes can involve the operation of cases. It can involve the administration of cases, when the dispute is between a trustee and the U.S. Trustee. The court can and should resolve those disputes.

I suggest to you, Mr. Chairman, that had the U.S. Trustee Program adopted a dispute resolution mechanism to avoid the conflicts of personality that led to micromanagement, we might not have the need for a legislative solution but it didn't do that. If the U.S. Trustee adopts now a dispute resolution mechanism that can work to resolve disputes before they go to the bankruptcy court, we won't have very many issues that go to the bankruptcy court. But if we only defer to the Washington bureaucracy, to the inside-the-beltway folks, the decisions as affecting those 48 families that I saw yesterday, and how their cases are administered, we have made a big mistake. I believe the ultimate decision on how cases should be handled rests in the U.S. Bankruptcy Court.

Those are the basic foundations and tenets upon which I think this committee has to make a determination. Are we going in the right direction? I think my written testimony indicates I think it started out very well but we've been diverted.

I wish to correct a statement previously made. In the first panel there was talk about "all these" trustees making maximum compensation. There are only two jurisdictions in the United States where the chapter 13 trustee makes the maximum statutory compensation. Those are in Alabama and North Carolina, jurisdictions outside of the U.S. Trustee Program, because in every other jurisdiction the chapter 13 trustee is paid only a percentage of the maximum allowed compensation that's fixed in the statute.

So, with that, I'd leave myself available for any questions, and I welcome the opportunity to respond.

[The prepared statement of Mr. Hildebrand follows:]

PREPARED STATEMENT OF HENRY E. HILDEBRAND III, CHAPTER 13 TRUSTEE, U.S. BANKRUPTCY COURT FOR THE MIDDLE DISTRICT OF TENNESSEE

Mr. Chairman and members of the committee, my name is Hank Hildebrand and I am a bankruptcy trustee. I have been a Chapter Thirteen trustee since 1982, a Chapter Twelve trustee since 1986 and, occasionally, a Chapter Eleven trustee. I serve in the Middle District of Tennessee and, since my appointment, I have been actively involved in and administered about 49,000 Chapter 13 bankruptcy cases. Working with Suzanne Schulman, the second Chapter Thirteen trustee in Nashville, our office administers about 13,000 active, ongoing Chapter 13 cases, disbursing close to $80 million to creditors annually at a cost of about 3.1% of total disbursements.

I have served as president to the National Association of Chapter Thirteen Trustees (the NACTT), an educational organization created to provide training and other services to Chapter 13 trustees, their staffs and to parties actively involved in the administration of consumer bankruptcy, I continue to serve on its executive committee. I also chair the legislative committee of the NACTT. I serve as the case notes editor to The Quarterly, the publication of the NACTT. Although I have been actively involved in the educational activities of the NACTT, the views I present here are my own and do not reflect the position of the NACTT, its board of directors or its membership.

A point should be made about the genesis of the NACTT. It was created more than 30 years ago by several Chapter 13 trustees who felt that the best source for education, support and technical assistance rested in other experienced trustees. The focus of the NACTT has been, and continues to be the education and assistance of Chapter 13 trustees—and it continues to be the only meaningful source of assistance, training and education available to those trustees. Experienced trustees are a valuable but underutilized resource to review and assist in the supervision of the consumer bankruptcy system.

I have always enjoyed the opportunity to serve as a Chapter Thirteen trustee. As Trustee I have the chance to hone my courtroom skills, monitor developing case law in the field, and apply administrative skills to operate an office of 40 employees.

My experience has led me to conclude that there are four basic and essential functions of a Standing Trustee in bankruptcy. These functions can be summarized as follows:

1. A trustee must serve as a fiduciary to the bankruptcy system, fully accountable for all funds and property conferred upon the trustee. As a fiduciary, the trustee is held to a high standard, accountable to all of the beneficiaries of the trust and subject to the jurisdiction of the court.[1]
2. A trustee is an advocate, statutorily charged with the responsibility to litigate in bankruptcy cases as a party in interest, advocated for the under and under-represented. The Trustee becomes an ombudsman for the individual reorganization process, participating fully in all court procedures that affect a Chapter Thirteen program and Chapter Thirteen cases.[2]
3. A trustee must provide information to all parties in interest, providing complete and understandable details of cases in the trustee's charge as well as the operation of the system.[3]
4. A trustee must operate a small business, operating an office in a fiscally responsible manner, while assuring all parties that Chapter 13 plans approved by the Court are administered as outlined by their terms.

My actions as a trustee have been guided by these basic goals. Most trustees seek to work within this same framework.

For six years I served under the system that existed prior to the implementation of the United States Trustee system. Along with many others in the bankruptcy field, I looked forward to the implementation of the UST system. I had experienced first hand the difficulties that the bankruptcy courts had in dealing with Chapter 11 cases in which there was little or no creditor involvement. I had experienced the difficulty that the individual judges had in selecting trustees to serve in cases before them. I knew the difficulty that faced a Court when questionable trustee practices were suspected and there was no entity with the authority or the ability to inves-

[1] A trustee is a fiduciary of the highest order, who is required meticulously to observe the fiduciary relationship and to perform the obligations of a trustee to the cestui que trust, and he is held to a high standard of conduct with respect to administration of the trust. 90 CJS *Trusts* Sec. 247, p. 238.

[2] See, generally, 11 USC 1302(b). See also, Report of the Committee on the Judiciary S. Rep. No. 95–989, 95th Cong., 2nd Sess. 139 (1978).

[3] See 11 USC 704(7) made applicable to a Chapter Thirteen trustee by 11 USC 1302 (b)(1).

tigate and take appropriate action. I was concerned over the cost of creating a new bureaucracy to participate in the process, but I was convinced that the Congressional policy would be recognized and the UST would become a new and welcome ally in my bankruptcy practice but limited in cost and scope.

I was encouraged by the appointments that were made by the program. I know many of the professionals that serve and have served in the position of United States Trustee and Assistant United States Trustee. I know many of them to be dedicated, hard working professionals who struggle to accomplish the goals of improving the bankruptcy system. The attorneys that serve in the program were often some of the best bankruptcy attorneys in an area.

But, Mr. Chairman, I believe that the cost of the program, the unjustified growth in the program, and the dangerous "mission creep" that infuses the program and the lack of accountability has detracted from and, in many ways, overshadowed the benefits of the UST program. The recent developments in the program—as the program seeks to establish a "one size fits all" approach—have undermined the morale of those involved in the bankruptcy system—including local U.S. Trustees and assistants who have seen the decision making process move inside the beltway.[4] It is appropriate, therefore, for this Committee to examine carefully what Congress intended in setting up the United States Trustee program, to limit the growth and cost of the program and to prevent it from deviating from its legitimate and appropriate goals.

It is with regret that I now see my hopes for the U.S. Trustee Program dimmed by a bureaucracy that is weighed down with excessive paperwork, significant duplication of effort, and excessive and unwarranted micro-management of private fiduciaries. The proliferation of "standards," "initiatives," "guidelines," and "requirements" that are dictated by the United States Trustee Program are far beyond the intent of the original crafters of the U.S. Trustee Program and seek to supplant the discretion of the fiduciary and usurp the traditional role of the judiciary.

Congress clearly intended for the United States Trustee to exercise limited supervisory functions over Standing Trustees. Congress intended, however, that the authority was to be locally based.[5] The United States Trustee was conferred the statutory authority to "supervise" Standing Trustees, but Congress recognized that independent Standing Trustees had performed well under the then existing system.[6]

The United States Trustee Program has been engaged in a long process over the past several years to promulgate complex and detailed standards and guidelines to cover the detailed operations of Standing Trustees. The efforts of the governmental agency are clearly designed to circumvent and limit the discretion of Standing Trustees to an unprecedented degree. What is also clear is that the U.S. Trustee is seeking to usurp the authority generally conferred upon the Court over the administration of bankruptcy cases in its jurisdiction.

The United States Trustee Program crafted a complex series of standards and guidelines beginning in the fall of 1994, prior to Mr. Joseph Patchan's tenure at the Executive Director position. Although Mr. Patchan made a commendable effort to solicit reaction to the end product, the genesis of the standards was already flawed. The U.S. Trustee program initially set out to craft detailed uniform, national standards with no initial input from any other party involved in the bankruptcy process. Despite Mr. Patchan's efforts to solicit feedback, the initially deficient creation of the standards and guidelines made such actions exercises in futility. The initial crafting (and the subsequent redraft) was created without the meaningful input of others involved in the process: the judiciary, the Standing Trustees, the creditor and credit community, and debtors. Although the Executive Office of the United States Trustee did reflect some of the comments in its redrafted proposed guidelines and standards issued on April 22, 1996, in the view of most participants the process was already hopelessly flawed.

I am aware that the NACTT has offered its assistance to work towards bringing these five interested groups together to craft meaningful standards and guidelines that are helpful to all creditors, debtors, trustees, clerks and the judiciary. I am encouraged by Mr. Patchan's willingness to consider this offer.

---

[4] See generally, Alberto, Christopher & Moore, Karen, *Reinventing The United States Trustee Program: A View from the Inside.*

[5] "The United States Trustee for the district will also supervise the performance of private S . . ." H.R. Rep. No. 595, 95th Cong. 1st Sess. (1978) U.S. Code Cong. & Admin. News at 6067.

[6] This system will allow the retention of private Standing Chapter XIII trustees that have performed [so] well under current law. The Attorney General will be able to utilize the private sector to provide the personalized and efficient service and to keep subordinated employees of the standing trustee off the public payroll." H.R. Rep. No. 595, 95th Cong. 1st Sess. (1978) U.S. Code Cong. & Admin. News at 6068.

The "one size fits all" detailed standards and guidelines are particularly troubling when the Standing Trustee is intended to be independent. A Chapter 13 trustee is not an agent or employee of the United States Trustee. A private trustee is free to pursue the collection of assets or implementation of a plan without the cost and delay of excessive governmental intrusion. Congress intended to create an independent fiduciary vested with the discretion to carry out the obligations to the trustee in the manner best suited in the judgement of the trustee to fulfill the obligations of that trust. Although the trustee must account to the court and to the United States Trustee to force the independent fiduciary to conform to detailed conduct prescribed by the United States Trustee places that trustee in an uncomfortable dilemma. The fiduciary must decide whether to exercise discretion as he or she deems fit, perhaps to comply with local court requirements, or defer to the United States Trustee, as its supervisor, to make such decisions. Unfortunately, the "supervisor" of a Standing Trustee often has little, if any, practical experience in administering Chapter 13 cases or in operating a trustee's office. The problem is exacerbated when the true supervisor is not the Regional United States Trustee as contemplated by Congress, but is actually a governmental employee crunching numbers in Washington, D.C.

Chapter 13 Trustees administer offices utilizing funds dedicated for that purpose paid by debtors from their plan. Chapter 13 trustees currently submit to the United States Trustee detailed budgets relating to how they intend to operate their offices in the fiscal year to follow. In reviewing such budgetary proposals, there may be a genuine disagreement between the Standing Trustee and the supervising U.S. Trustee as to whether a particular action or expenditure of funds is appropriate. Because 11 U.S.C. § 586 confers upon the United States Trustee the authority to establish the compensation of each Standing Trustee, the discussion is, unfortunately, not a dialogue. Budgets submitted to the United States Trustee have been modified by members of the United States Trustee System. If a Standing Trustee does not agree with a proposed modification, the U.S. Trustee can deny compensation and the trustee simply will not be paid. In fact, the U.S. Trustees' "Standing Trustee Initiatives" seem to require the elimination of compensation to trustees if there is a disagreement between a trustee and the United States Trustees:

> The failure of the Standing Trustee to provide an adequate budget proposal as well as undertake satisfactory efforts to correct deficiencies as set forth in an audit, ALS Audit, or office visit, shall *require* that the compensation level be set at zero, when the percentage fee is established thereby precluding the Standing Trustee from drawing any compensation until the matter is resolved (at page 13) (emphasis added).[7]

Further, if a disagreement arises between the Chapter 13 Trustee and the United States Trustee, the United States Trustee could elect to cease assigning cases to that Standing Trustee. Although Congress contemplated that the removal of a Trustee would be governed by 11 U.S.C. § 324, giving all parties notice and an opportunity to be heard, such protection does not exist should the United States Trustee need to accomplish the same results. A Chapter 13 Trustee that disagrees with the United States Trustee faces the real risk of receiving no compensation and no further cases.[8] No practical judicial review is contemplated or allowed by the U.S. Trustee.

Congress established the United States Trustee with the clear thought that the U.S. Trustee would not be a political appointment. H.R. 5316 established the term of the United States Trustee at five years rather than the four year term originally proposed in the House bills. This was done to minimize the politicization of the Office of the United States Trustee. The bill required the Attorney General to find "cause" to remove the United States Trustee, again to minimize undue political influence.

Despite this intent, the office has become politicized. The Attorney General has now certified the United States Trustee position as a "political position" rather than the initial intend of a nonpolitical position.[9] Even prior to the designation of the Attorney General of the United States Trustee Position as a "political position," the turnover of the United States Trustees has been significant. None of the United

[7] "Standing Trustee Initiative," March 19, 1993 at page 13.

[8] "Because the Standing Trustee serves no definite term and Congress made no explicit provision to the contrary, the party with the power of appointment may terminate that appointment at any time by refusing to assign new cases to the Standing Trustee." Richmon Straley, 48 Fed 3rd 1139 (10th Cir. 1995).

[9] See "Order Exempting United States Trustees From Civil Service Due Process Requirements" dated January 11, 1996.

States Trustees appointed by the previous administration has been re-appointed under the current Attorney General. Between 1989 and 1993, fourteen United States Trustees resigned or were not reappointed, only four for performance related reasons.[10]

The United States Trustee has a legitimate role to play in the administration of the bankruptcy system. Included in the scope of the responsibility of the United States Trustee is the responsibility to watch over the operations of a Standing Trustee. I strongly support that concept. I do believe, however, that the United States Trustee is not the final authority deciding how bankruptcy cases are to be administered. The functions of the United States Trustee Program are important but limited to those tasks that have been articulated by Congress. Those tasks are:

The United States Trustee should appoint qualified trustees. The appointment power vested in the United States Trustee Program removes the court from the appearance of favoritism and cronyism that has plagued the system in prior years. The United States Trustee should take into consideration tasks that face the Standing Trustee and seek to appoint qualified individuals to those positions. Once appointed, however, the United States Trustee should not have the unlimited freedom to arbitrarily remove trustees absent providing those trustees and the bankruptcy community notice and an opportunity to be heard under 11 U.S.C. § 324.

The United States Trustee should appoint independent auditors who will carefully monitor and scrutinize the financial operations of a Chapter 13 Trustees office. The auditors can, should, and do pay close attention to the expenses of a trustee to be certain that a trustee is aware of the fiduciary obligations on a trustee.

The United States Trustee should monitor Chapter 11 cases in which there is no creditor involvement. The U.S. Trustees' goal should be to move cases out of the system when there is little or no interest in reorganization. Such duty in a Chapter 11 case, however, does not necessarily apply in a Chapter 13 where a private trustee is charged with the duty of monitoring and moving those cases. The United States Trustee Program should not duplicate the efforts of the private trustee.[11]

The United States Trustee should seek to dismiss abusive Chapter 7 cases. Congress has mandated such actions in 11 U.S.C. § 707(b).

The United States Trustee should review applications for professional compensation as mandated by the Bankruptcy Reform Act of 1994.

The United States Trustee should present conflicts to the court. If the United States Trustee believes that any Trustee is acting improperly or that any expenditure of the trustee fund is overreaching, inappropriate or does not reflect a reasonable and necessary expenditure of a trustee, the United States Trustee should bring that matter to the attention of the court, either seeking disapproval of the proposed expenditure, the mandating of needed expenditure, or, if appropriate, actions to remove the trustee.[12]

Congress never intended to supplant the jurisdiction of the Bankruptcy Court with that of the Washington based bureaucracy. Courts have recognized the existence of judicial authority not withstanding the presence of the United States Trustee. In the case of *In re Meyer*, 147 B.R. 221 (Bankr. OR 1992) the Bankruptcy Court rejected the United States Trustee's argument that the Bankruptcy Court lacked subject matter jurisdiction to consider the reasonableness of the expenditures of a Standing Trustee. The court concluded that the review of what constituted actual and necessary expenses incurred by a trustee is a matter which clearly concerns the administration of estates in which the Standing Trustee serves. "Congressional in-

---

[10] The National Academy of the Public Administration, "Alternative Structures for the United States Trustee Program," May, 1995 at page 40.

[11] Kelly, Larry and FitzSimon, Jean, *The U.S. Trustee System: Whence, Wither and Why* at page 24: "It is the authors' view that . . . the United States Trustee should ensure that creditors and other parties in interest are well informed as to the terms and conditions under which they are operating and given the opportunity to bring before the court any disputed point. If creditors and other parities are satisfied to go forward with the case after all facts have been disclosed with or without the assistance of the United States Trustee, the United States Trustees only further role is to ensure that the game ends on time and no federal laws are broken. The United States Trustee should not substitute his or her judgement on the proper outcome of the case for that of the parties of the pecuniary interest. Only if the parties reach a solution that is patently illegal or otherwise violative of public policy should the United States Trustee intervene."

[12] In *Berry* v. *Chapter 13 Trustee*, 153 B.R. 66 (W.D. Wash. 1993), the District Court recognized that the issue of what trustee expenditures of a trustee cure reasonable and necessary is a core matter, jurisdiction over which is conferred on the bankruptcy court.

tent indicates that the bankruptcy court was not intended to be removed from determinations such as these."

The leading bankruptcy treatise acknowledges the jurisdiction of the court to determine where necessary—the reasonableness or necessity of trustee expenditures:

> In cases under Chapter 7, 12 and 13, the United States Trustees' role will be primarily limited to a review of the trustees handling of the cases. However, they may well direct the trustees to take or not take a particular action in a case. The case trustee, in such circumstances, will have to use such direction as fiduciary of the case. If the case trustee's judgement differs than the United States trustee's, the case trustee must either seek court authority, if appropriate, or follow his or her judgement subject to a possible challenge by the United States Trustee in the court.[13]

In my opinion, the United States Trustee Program should focus its resources on the needs that exist in the system. The government agency should defer to the discretion of the fiduciary ultimately charged with the responsibility of administering cases. Reliance upon a competent, professional, private fiduciary reduces costs to the system, avoids needless duplications, and recognizes that the best person to judge a need is often that person closest to the problem. If the United States Trustee perceives that a fiduciary is acting in a manner inconsistent with the fiduciary responsibilities, the U.S. Trustee has an obligation to challenge the reasonableness and necessity of such expenditures and conduct before the Bankruptcy Court, the Court to whom such action is directed.

Such will not, however, inundate the courts with numerous issues of disagreement. The United States Trustee Program should, but as of yet has not, implement an internal appeals policy in an effort to resolve disputes prior to litigation. This only makes sense. Where, however, such internal appeal process is unsuccessful, the Bankruptcy Court should and does retain the responsibility and authority resolve disputes as "matters concerning the administration of the estate" which affect all chapter 13 cases committed to its jurisdiction.

Mr. GEKAS. We'll receive a report from the clerk as to what's happening on the floor before we proceed.

We will recess until the pending vote has been concluded, and we will be back in session at 11 o'clock.

[Recess.]

Mr. GEKAS. The hour of 11 o'clock having arrived and passed, the Commercial and Administrative Law Subcommittee will come to order.

We apologize for the necessary interruption, and we will proceed with the second witness in this panel, Mr. Morin. You may proceed, Mr. Morin.

STATEMENT OF LAWRENCE P. MORIN, PRESIDENT, ASSOCIATION OF BANKRUPTCY PROFESSIONALS

Mr. MORIN. Good morning, Mr. Chairman, and thank you for inviting me to appear before you this morning.

As you've acknowledged, my name is Larry Morin. I'm the chapter 13 trustee in Lynchburg, VA, and the president of the Association of Bankruptcy Professionals. And it's in that capacity that I'm here today.

I'm reminded of a comment or a quote that the gentleman to your right, I must give him credit for, and he said that "everything has been in Congress at least once, but not everyone has said it." So, in that regard, I believe many of us are saying things today that are not new. We may be putting a different spin on it, and we appreciate your hearing us as to our concerns.

I would like to take the opportunity to do what I call, go back to basics. The concept, as Mr. Hildebrand has so aptly described,

---

[13] Collier on Bankruptcy, 15th Edition, par.6.19 page 6–84.

is really what all of us in the bankruptcy process deal with, even the people at the U.S. Trustee's Office who work at a different level in terms of not dealing with debtors individually, nonetheless, have to face the massive rise of bankruptcy filings, the debt structure of this country, dealing with the concerns of creditors. It's a balancing process.

I would like to view a trustee in a bankruptcy case, or in the case of a standing trustee of an entire caseload, as being the administrator of that balancing process at the local level. In that regard, we have readily accepted, and will continue to accept, our role as fiduciaries, and we welcome the concept of oversight by the U.S. Trustee Program or any other agency, including the courts, that is charged with that responsibility. It's a grave responsibility, and it's one that we, in our capacity, do not diminish in any way.

But what really has happened, in our view, is that the exercise of that authority has grown beyond its originally-contemplated limits and appears to be getting out of hand. It is getting out of hand in terms of the manner in which directives are being communicated, the manner in which policies are being implemented, the manner in which the whole focus of trust is being evaluated. In simple terms, we're very concerned that the "trust" has left the "trustee" concept.

In that regard, perhaps the level of trust can be founded on communication. It can be founded on practices. We do believe, and we will acknowledge, that there are inappropriate activities that our fellow trustees, chapter 13 trustees, have over the years done things they shouldn't have done. And in that regard, we have sought to inquire what those may be, what matters, what particular transactions the U.S. Trustee Program may consider to be inappropriate. We're still waiting to have that information shared with us.

However, I would be very quick to point out that many, if not all, of these inappropriate transactions do not rise to the level or dignity of being characterized as substantial or abusive. In many instances they are matters that are covered by prior approved transactions from the U.S. Trustee Program, but then after-the-fact are categorized as being "inappropriate." And many of the transactions that have occurred have, in fact, been remedied promptly by the standing trustee, when it's been called to their attention. In that regard, we are concerned that if there are transactions which the trustees have done that may be improper, there could also almost be a whispering campaign going on as to the sharing of this information that we need and have the right to know about.

I would also like to take this opportunity, having had the benefit of listening to Mr. Patchan, whom I genuinely like and respect, as well as reading his testimony, I would like to refute a couple of the things that he said in his written testimony. In his written testimony he made reference to an amendment pending in the Senate to section—to title 28, section 586. That is not so. The amendment is to sections of title 11, chapter 13, in particular—excuse me, chapter 3, particular sections 330 and 324, which deal with the general review by courts of expenses and determination of cause for removal of trustees.

This is not legislation that is intended to be an erosion of U.S. Trustee authority; it is intended to create a balance. It is intended to create a means by which judicial review of expenses, not of compensation or fees, may be determined. It is a means by which fairness can be brought to the process, by which the playing field may be leveled, and by which responsible supervision may then be brought into place.

It is from that perspective that we ask this committee to consider. And, in view of the fact that the red light is on, I will thank you for hearing me.

[The prepared statement of Mr. Morin follows:]

PREPARED STATEMENT OF LAWRENCE P. MORIN, PRESIDENT, ASSOCIATION OF BANKRUPTCY PROFESSIONALS

Mr. Chairman and Members of the Committee:

Introduction

My name is Larry Morin, and I am a bankruptcy trustee. For the preceding twenty-six years, I have been engaged in the practice of law, primarily as a sole practitioner. Since October 1, 1979, I have served as the Standing Chapter 13 Trustee in Lynchburg, Virginia.

On April 24, 1996, I appeared before the U. S. Senate Committee on the Judiciary, Subcommittee on Administrative Oversight and the Court, with Senator Charles E. Grassley presiding. It is my understanding that the complete record from that hearing has been made available to the House Judiciary Committee on Commercial and Administrative Law. This record should include my written testimony, a transcript of my oral testimony, and my written answers to follow up questions. If additional information is required, please let me know. Assuming that my understanding is correct, I will use this opportunity to supplement rather than merely repeat my earlier comments.

I want to thank the Subcommittee not only for convening this hearing, but also for giving me the opportunity to appear before you today. My appearance is in my capacity as the President and Chairman of the Board of The Association of Bankruptcy Professionals, Inc. ("ABP"). This organization not only represents the

vast majority of chapter 13 trustees, but also is open to membership to creditor's representatives and to debtor's counsel.

ABP was formed in the fall of 1993 in response to the need to empower an organization with authority to propose legislative measures to deal with issues as to the action and conduct of the U. S. Trustee program. During the two and one-half years' of ABP's existence, the problems with the U. S. Trustee program have intensified, so that the need for our voice as to these matters has become more important than originally anticipated.

Excessive "Oversight": a bureaucracy out of control

In the Bankruptcy Reform Act of 1978, Congress empowered judges to adjudicate factual and legal disputes, and delegated only the general administration of bankruptcy estates to the United States Trustee. This general administrative power included the responsibility to supervise the private trustees serving as independent fiduciaries. With respect to the U. S. Trustee's "supervisory duties" regarding chapter 13 standing trustees, Section 586 of Title 28 provides as follows:

> (a)(3) supervise the administration of cases and trustees in cases under chapter 7, 11, 12 or 13 of title 11 ...; and
>
> (e)(1) The Attorney General, after consultation with a United States Trustee that has appointed an individual under subsection (b) ... to serve as standing trustee in cases under chapter 12 or 13 of title 11, shall fix -
>
> (A) a maximum compensation for such individual consisting of ...; and
>
> (B) a percentage fee not to exceed --
> (i) in the case of a debtor who is not a family farmer, ten percent;

35-307 O - 96 - 2

> (e)(2) Such individual shall collect such percentage fee from all payments received by such individual under plans in the cases under chapter 12 or 13 of title 11 for which such individual serves as standing trustee. Such individual shall pay to the United States Trustee System Fund --
>
> (A) any amount by which the actual compensation of such individual exceeds 5 per centum upon all payments received under plans in cases under chapter 12 or 13 of title 11 for which such individual serves as standing trustee; and
>
> (B) any amount by which the percentage fee for all such cases exceeds --
> (i) such individual's actual compensation for such cases, as adjusted under subparagraph (A) of paragraph (1); plus
> (ii) <u>the actual, necessary expenses incurred</u> (emphasis added) by such individual as standing trustee in such cases.

The problems that have arisen and intensified deal with the U. S. Trustee's attitude and interpretation concerning its supervisory powers, with particular emphasis as to whether they have the absolute, unfettered authority to "fix" the trustee's "actual, necessary expenses". In an ever-growing number of instances, the U. S. Trustee has engaged in substituting <u>its</u> judgment and business decision for that of the private trustee as to individual business expenses, and has <u>micro managed</u> the trustee's expense budgets to the point of harrassment.

The power of the U. S. Trustee to exercise such overseight was not intended by Congress to include unfettered authority for the United States Trustee to substitute its judgment for that of the private trustee. Rather, the United States Trustee has pushed its interpretation of its authority to the point that this agency contends that ONLY the U. S. Trustee can decide what

expenses a standing trustee may be allowed to incur. This leads to its further conclusion that there cannot be any avenue of appeal or review beyond whatever self-contained administrative review may be allowed to exist within the confines of the U. S. Department of Justice, without any recourse for judicial review. This attitude disregards the provisions (11 U.S.C. Sec. 330) by which all other fees and expenses in bankruptcy case ARE subjeot to final approval by the Court. In fact, in Mr. Patchan's written testimony before the Senate Judiciary Committee, he stated that,

> "Every other professional employed by a bankruptcy estate must have their fees approved -- standing trustees are no different, as the statutory language of 28 U.S.C. Sec. 586 makes clear. The compensation of standing trustees is limited to 'actual and necessary expenses'. [Patchan statement at p. 4].

By Mr. Patchan's very admission, the expenses of standing trustees should ALSO be subject to court approval. However, Mr. Patchan blends "compensation" and "expenses" into one glob - they are different, and the Code makes it clear that it is the U. S. Trustee's responsibility to "fix compensation", which is set in terms of a stated dollar amount. We are not asking the Congress to alter that responsibility. Rather, the Code does not say that the U. S. Trustee has the exclusive power and authority to BOTH "fix compensation" and to "determine what expenses are aotual, necessary". To the extent that the existing language of the Code has allowed the U. S. Trustee to conclude that it DOES have such authority, now is the time to remove and correct the U. S. Trustee's erroneous conclusions and determinations.

In addition, the United States Trustee has taken upon itself the power, and has imposed the additional threat, that it may arbitrarily "remove" a standing trustee without a showing of any cause. This "removal" occurs by the actual cessation of the assignment of future cases to a standing trustee, which in effect constitutes a "de facto removal" without the trustee having any avenue of administrative or judicial appeal or review. In fact, at this time in Arizona, such a "de facto removal" is going unchecked against a standing trustee as to future cases. This exercise of power improperly interferes with the independent fiduciary's role envisioned by Congress in the creation of the private standing trustee. Because it involves an adjudication of a factual dispute, the power of trustee removal as to all cases should be vested with the court, not only with respect to pending cases as is currently provided for under the Code (Sec. 324), but also with regard to the assignment of future cases to a trustee who has otherwise been appointed and qualified by the United States Trustee.

Therefore, consistent with Congress' intent that the judicial and administrative function in bankruptcy be separated, we ask that Congress enact legislation as offered by Senator Grassley in his amendment to the Technical Corrections Bill (S.1559), which will not only clarify that the bankruptcy court does have jurisdiction to hear and resolve these disputes as to whether expenses of a standing trustee are "actual, necessary", but also that the bankruptcy court does have jurisdiction and

authority to determine, upon a properly commenced hearing, to determine whether cause exists for the removal of a trustee from the assignment of future cases. This statutory change is essential not only to provide the standing trustees with the same mechanism for judicial dispute resolution currently afforded to all other professionals under the Bankruptcy Code, but also to clearly state to the U. S. Trustee that Congress never did intend for its authority to be beyond review or appeal. In the absence of such a legislative change, there will continue to be no means by which disputes or disagreements between the United States Trustee and standing chapter 12 and 13 trustees can be resolved or appealed. At the present time, the U. S. Trustee appears to be justifying its position as to the cessation of future case assignment as to whether or not the trustee's continued service "appears to be suitable". It is this very kind of attitude and justification and abuse of authority that must be stopped now.

Please do not be mislead by those who would claim that such a statutory provision would lead to a "rush to the court house". This is classic "Peter and the Wolf", or at best "Chicken Little" mentality. As a practical matter, a standing trustee will have to take a long, hard look at his/her position before exposing it to scrutiny by a Court. And, so too the U. S. Trustee will have to reconsider its position vis-a-vis a standing trustee's request for a budget line item approval, before having that position (of denial) exposed to due process considerations. Recognizing that some Courts may not want to engage in its own version of "number

crunching", the Courts should be at liberty to refer these matters to a neutral third party such as a Special Master, Commissioner or Examiner, who then could conduct the appropriate investigation and examination and submit a report for the Court's consideration.

Anticipated responses from U. S. Trustee

Please do not be cajoled or mislead by the representations made to you by representatives of the U. S. Trustee's Executive office in support of what they have done or have declined to do.

To the extent they may suggest that there are administrative review and appeal procedures in place, such a representation is erroneous. No such procedures ever have been communicated to the standing trustees or to their representative associations. And, the most recent suggestion that Mr. Patchan may have written a letter to the chapter 7 trustees as to such a procedure, not only has never been communicated to the standing chapter 12 or 13 trustees, but also really offers nothing more than an "appeal" to himself. If there IS an administrative review procedure in place within the Department of Justice, not only has this not been shared with or shown to the trustees, but also it probably is confined to resolving disputes as to government employees, and the standing trustees are private, non-governmental employees. Even giving Mr. Patchan the benefit of the doubt that he might consider overruling a decision of one of his Regional Trustees, nevertheless there is no further avenue of appeal to any higher authority.

To the extent that they may suggest that they are in the process of developing Standards of Conduct which are to be promulgated in the Federal Register, which are to be made "subject to comment", and then to become binding rules under the Administrative Procedures Act, there are several fallacies to such a representation.

First, while there have been several meetings where U. S. Trustee representatives have listened to "comments" from trustees and other interested parties, there has been absolutely no meaningful response to, or dialogue between the U. S. Trustee program and standing trustees, no "give and take" discussions, and no willingness and actual evidence of compromise. In fact, it has been said of this "comment period" that "Your (U. S. Trustee's) actions speak so loud, that we cannot hear your words". Most recently at the NACTT Annual Seminar on July 3, 1996 in San Francisco, the U. S. Trustee representatives hammered away at their old, trite themes, would not allow or would not make any direct response to the questions posed from the floor, and in essence crammed their program down the throats of the trustees in attendance.

Second, while Mr. Patchan did assemble what has been described as his "Advisory Board", consisting of four bankruptcy judges and other members of his own organization, it can only be concluded from the product - or lack of product - of that Board that any "advice" generated from the judges was not implemented. No chapter 13 trustees were invited to participate in this

process notwithstanding the suggestion by one of the judges as noted below. How can a board that is truly and sincerely meant to be "advisory" be stocked with members of the very U. S. Trustee program that has created and perpetuated the very communication barriers that the trustees have sought so vigorously to push aside? During ABP's appearance on February 1, 1996, before the Advisory Board, The Honorable Sidney Brooks, Judge, from Colorado, suggested that Mr. Patchan should designate two of his representatives to meet with two members of ABP to discuss the differences between the two groups. That suggestion has remained unanswered, which is further indication of what the U. S. Trustee considers to be "communication".

Third, at that same meeting before the Advisory Board, ABP learned for the first time about the so-called book with the list of "substantial abuses". Following that meeting, ABP made two informal requests for these materials so that we could learn and better understand not only the actions by individual trustees that the U. S. Trustee considered to be "abusive", but also to try to propose mutual and meaningful criteria to identify, resolve and remove these actions. To ABP's request, the silence was deafening. Even during the Senate Judiciary Committee Oversight hearings, this request was renewed, but again there hs been no response. Therefore, ABP initiated a request for these documents under the Freedom of Information Act ("FOIA"); again, the response has been non-existent, except to acknowledge that "they are working on it". These are, in all likelihood, the very

same so-called "abuses" which the U. S. Trustee is parading around the Halls of Congress to support their posture and to justify their continued existence. Yet, no consideration has been given as to:

1. what the transactions were that are considered to be "abusive";
2. how long ago they may have occurred;
3. how and by whom they were discovered;
4. what actions were taken by the U. S. Trustee, and what responses or corrective actions were taken by the "guilty" standing trustee;
5. the dollar amount of the alleged infraction;
6. the nature of the transaction, and whether it was willful or deliberate, accidental or inadvertant;
7. whether the U.S. Trustee had, in fact, previously approved the transaction only to later decide that it should be considered to be an "abuse".

These are just some of the questions which need to be asked and answered before the U. S. Trustee's labeling of these actions as "substantial abuses" by trustees deserve <u>any credibility</u> or to be characterized as "abuses", or even "substantial".

Further, to the extent that the U. S. Trustee represents to you that there are many problems and abuses which <u>they</u> have uncovered, and therefore many more to be discovered, we suggest to you the following:

A. that their practices and policies which are manifested as micromanagement do not relate AND HAVE NOT RELATED in any way to the actual discovery of fraud or embezzlement; in fact, Mr. Patchan acknowledged this in response to a direct question from Senator Grassley, as follows [Transcript, from line 14 on p. 67 thru line 11, p. 68]:

Senator Grassley: Following up on what you said just before Mr. Phelan took the floor Mr. Patchan, I have heard a number of complaints about the U. S. Trustee's Office

from Standing Trustees. Frankly, I was somewhat skeptical when I first encountered them, but as it turns out, many of these concerns are shared by creditors and debtors, and these, of course, are the very people who should be afraid that unsupervised Standing Trustees could defraud the system.

In light of this, do you believe that giving Standing Trustees the right of appeal on budgetary decisions made by the U. S. Trustees' office would lead to more fraud or otherwise endanger the bankruptcy system? [emphasis added]. The reason, obviously, is that if we are going to make policy here in Congress, we cannot do anything that is going to encourage or let fraud happen.

Mr. Patchan: No, I do not think so. I do not think one has anything to do with th eother. There have been some situation ...

Senator Grassley: In other words, we could have an appeal situation, but you do not think that would encourage fraud to happen?

Mr. Patchan: I do not think it would encourage it, no. I do not think it would have any effect on it.

B. that the cost of the U. S. Trustee program far exceeds not only the amounts discovered as having been misappropriated, embezzled, or even "used improperly" but also the cost benefit to creditors measured in terms of the actual benefits in the form of distributions they receive from the trustees have not and would not be increased;

From the testimony of Roger Efremsky before the Senate Judiciary Committee [Transcript, p. 39, line 9, though p. 41, line 12];

"The creditors are concerned that the U. S. Trustee is not focusing on the results that the chapter 13 trustees can accomplish, but is rather focusing on cutting costs. (emphasis added). I believe they are under the impression that by cutting costs, they will increase the benefits to the unsecured creditors in the form of dividends. [Rather] It is the unsecured creditor's position that it is just the opposite -- as a result of the [chapter 13 trustee] budget cuts, they are seeing a decrease in service from the Standing Chapter 13 Trustees and are having to increase their expend-

itures in their loss recovery departments ....

Regarding the U. S. Trustee's pending FY 97 budget request for a one-half percent surcharge, Mr. Efremsky elaborated in terms of "cost benefit" as follows [Transcript, p. 40, line 7, through p. 41. line 12]:

> "On another line is the recent information that I just received a few weeks ago and in that time had the opportunity to poll this national group of creditors at large, and there is opposition to the surcharge of one-quarter or one-half percent to be surcharged to the administrative fee that the Chapter 13 Trustees can charge. The creditors would ask the question of the U. S. Trustee what benefit it will have for the unsecured creditors, specifically, whose pockets this money will actually be coming out of. (emphasis added)
>
> "We see little if any benefit to the program being funded for that purpose. On the other hand, if the funds were to be used for bankruptcy fraud prosecution that might be another issue, but to date we have seen little prosecution in the consumer bankruptcy area.... The pat response that the creditors receive, either from the U. S. Trustee office or the Department of Justice, is that there is not enough money involved, or there is not enough evidence. We believe that if they made consumer bankruptcy fraud a priority, they would find that there is sufficient evidence to prosecute and that, yes, the dollars may be small in any one particular case, but it would send a loud message to those who seek haven in the chapter 13 area, who are attempting (tempted?) to commit fraud that it is not acceptable...."

C. that many of the so-called "abuses" are in fact more a misunderstanding or difference in interpretation of United States Trustee policies as between the standing trustee and the U. S. Trustee, and once explained, usually are resolved;

D. that as to many areas of supposed "abuse", the U. S. Trustee has in fact previously approved the standing trustee's budgets, usually for many years, with these very forbidden activities having been routinely included and approved by the very agency that now contents they are "abusive";

E. that the U. S. Trustee, rather than fixing an abusive practice with a individual trustee, seeks to create a blanket procedure which <u>has interferred with the performance by a trustee of his/her fiduciary duties</u>; as a result, the costs to bankruptcy administration have risen to the detriment of creditors, as well as in several instances, creating backlogs in the court.

F. and, even if a particular improper expense is resolved, it appears that the U. S. Trustee continues to hold information in its files against all trustees or at least against the particular "violator" for future reference of that trustee's misconduct.

<u>Where is the "TRUST"?</u>

It is important to remember that at first the U. S. Trustee thought enough of and had enough TRUST in the individual to be appointed as a Standing Trustee, but as soon as that trustee started his or her operations as trustee, a new <u>mindset based on a fundamental MISTRUST</u> became evident, with no apparent action or prompting by the standing trustee.

It has taken many years for the Chapter 13 Trustee program to evolve, and most of those occurred long before the U. S. Trustee came on the scene. Most recently, the computer age has enhanced record keeping as well as case management. The Courts have grown to rely on the expertise as well as the judgment and evaluation skills of the individual standing trustees serving in each area, and this skill and knowledge is something that the trustees themselves - through their own initiative and organizations [notably the National Association of Chapter 13 Trustees {"NACTT"}] - have developed the ability to <u>TRAIN</u> themselves and their staffs. Please do not think for one minute that the United States Trustee program has contributed in any significant way to

this training process. In fact, the U. S. Trustees now seek from the standing trustees explanations as to basic concepts of bankruptcy law and procedure; but, the Standing Trustees fear that once this knowledge, expertise and skill has been "shared", that there is grave risk that this very knowledge may be turned on and used against the trustees to question their judgment. In his remarks to the trustee's at the NACTT Conference on July 4, 1996, in San Francisco, CA, Mr. Patchan once again asked for the trustee's help in "training his people" so that THEY could better do their job. In the current climate of mistrust, why should trustee's take time from their schedules and pressures to show members of the U. S. Trustee program how it is done, only to sit and wait for the U. S. Trustee zealot to turn this very information on the trustee to criticize or falsely accuse the standing trustee of committing some sort of act that becomes characterized as a "substantial abuse"? This is just another dimension of the direction which the U. S. Trustee's micromanagement has taken.

Answers Needed from the U. S. Trustee

When writing letters or making pronouncements either to the general public or to the Congress, the U. S. Trustee program has employed broad, general embellishments as to its accomplishments, and usually is unable or unwilling to provide the hard facts in support of its sweeping generalities.

Recently, a series of questions have been propounded from the House of Representatives to Mr. Patchan's office, seeking detailed information as to the U. S. Trustee's in support of its:

(1.) assertion of "substantial abuses" by Standing Chapter 13 Trustees;

(2.) a report as to those instances where the U. S. Trustee has investigated and refered for action under Sec. 707(b) alleged instances of "substantial abuse" by debtors;

(3.) a report as to criminal referrals for alleged bankruptcy fraud from the U. S. Trustee to the U. S. Attorney;

(4.) evidence to support Mr. Patchan's letter to Senator Trent Lott (R-MS) that stated (on page 3) as follows:

> In the last few years, the Program has increased their scrutiny of the standing trustees overhead and expenses. This increased review has resulted in tremendous savings to the creditors. (emphasis added); and

(5.) a report as to the percent of resources used by the U. S. Trustee as to the actual supervision of standing chapter 13 trustees.

In addition, the U. S. Trustee has admitted that many of their proposed policies are based on perceptions rather than hard facts, and if they persist in avoiding meaningful, two-way discussions with the very parties who will be most affected by these policies, then their perceptions - most of which are flawed and inaccurate - will be allowed to prevail. The U. S. Trustee also has acknowledged that as to many topics or items of expense, these perceptions outweigh the need for any cost-benefit analysis. This is somewhat hypocritical, however, for when the U. S. Trustee seeks the support of creditor representatives, their message is that it is only because of their policies and

tactics that they [the United States Trustee] "... have saved millions of dollars for the creditors ..." by curing what they refer to as "abusive practices". In fact, if the U. S. Trustee's Standards were implemented as drafted, the cost to the system in terms of experienced, efficient personnel at trustee offices, not to mention competent, dedicated trustees, will have a major long term impact not only on the performance by trustee offices, but also on the cost of providing these services.

Total lack of a Dispute Resolution Mechanism

We also acknowledge and accept the need for oversight, audit and review of trustee practices and accounts. However, as problems or disagreements have arisen between Standing Trustees and the United States Trustee, we also acknowledge that in many instances these differences have been resolved. But, in many other instances, the Standing Trustee has had to capitulate to the authority asserted by the United States Trustee, which has only served to fuel the U. S. Trustee's posture as to future dealings, thereby encouraging them to expand their micromanagement.

But, if the U. S. Trustee persists in its manner and style, first of being accusatory towards the Standing Trustees of inherent wrongdoing, and then being set in their refusal to discuss and work out mutually acceptable procedures for fair and just guidelines and dispute resolution, then the prospect for any sort of working relationship will remain as it now stands, non-existent.

As mentioned earlier, this scenario has extended in several instances to the U. S. Trustee refusing to assign future cases to a trustee. And, in several instances, the U. S. Trustee has directed the Standing Trustee to operate his/her office without being allowed to take the previously authorized percentage fee to cover expenses. All of this has been done not only without any semblance of due process, but also without any reference to a court. In many instances, these decisions have been made by low level bureaucrats who have not even sought the approval or review of the Regional Trustee or the Executive Office.

Please do not be mislead by those who would claim that such a statutory provision would lead to a "rush to the court house". This is classic "Peter and the Wolf", or at best "Chicken Little" mentality. As a practical matter, a standing trustee will have to take a long, hard look at his/her position before exposing it to scrutiny by a Court. And, so too the U. S. Trustee will have to reconsider its position vis-a-vis a standing trustee's request before having that position exposed to due process considerations. Recognizing that some Courts may not want to engage in its own version of "number crunching", the Courts should be at liberty to refer these matters to a neutral third party such as a Special Master, Commissioner or Examiner, who then could conduct the appropriate investigation and examination and submit a report for the Court's consideration.

Mr. GEKAS. We'll get back. We'll get back.
Mr. Freedman.

STATEMENT OF JEFFREY M. FREEDMAN, ESQ., VICE PRESIDENT, NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

Mr. FREEDMAN. I want to take this opportunity to thank the subcommittee for allowing the National Association of Consumer Bankruptcy Attorneys to comment this morning on the U.S. Trustee Program. My name is Jeffrey Freedman. I practice law in Buffalo and Rochester, NY. My law practice is primarily that of consumer law. Since 1980, my law firm has filed well over 10,000 bankruptcy cases. We also have handled about 4,000 social security disability claims. From 1977 through 1984, I served as a chapter 7 trustee for the bankruptcy court in Buffalo.

I currently serve as the vice president of NACBA. NACBA was formed in 1992 for two main reasons. First of all, we wanted to ensure that consumer debtors are represented with respect to the legislative process, and we also want to assist attorneys who represent consumer debtors.

We approach the hearing today from two perspectives. As practicing attorneys, we have contact with the U.S. Trustee at the local level. Nationally, we have the opportunity to observe the operation of the U.S. Trustee Program from a broader view.

NACBA believes there are two main purposes that the U.S. Trustee Program should focus on at the local level. No. 1, uncover and eliminate fraud and corruption, and, No. 2, to speed up the administration of bankruptcy cases.

The U.S. Trustee Program has uncovered fraud and corruption by local U.S. Trustees. These individuals were removed. Some were prosecuted. Since 1986, all chapter 7 and chapter 13 trustees have been selected by, or are closely supervised by, the U.S. Trustee's office. Today fraud and corruption is a rarity with respect to trustees. Local trustees have strict financial reporting rules, and where fraud is found, the U.S. Trustee Program will move against it, and they should. That is their job.

Another proper purpose of the U.S. Trustee Program at the local level has to do with speeding up the administration of cases, and here the U.S. Trustee has done an excellent job. Prior to the U.S. Trustee Program, asset cases took way too long to resolve. That was my experience when I practiced as a trustee from 1977 through 1984.

However, there are problems that we perceive at the local level. Even though fraud and corruption by local trustees has been largely eliminated, the U.S. Trustee Program appears to attempt to justify their size and budgetary requirements. And what they're doing is they're trying to find different objectives to pursue, such as second-guessing local 13 trustees on budget issues.

NACBA's perception is the following: chapter 13 trustees should be allowed to exercise reasonable business judgment. They are fiduciaries, and they need some degree of discretion. Historically, chapter 13 trustees have acted diligently and have done a good job. I've been involved in well over 6 or 7,000 chapter 13 cases, and that's

been my experience. The chapter 13 trustees have attempted to provide excellent service to debtors, creditors, and the court.

However, at this time budgetary cutbacks in the chapter 13 trustee's operations, which have been mandated by regional U.S. Trustees, have led to a decline in services in some parts of the country. For example, some of the trustees are not able to hire or keep qualified staff. Some are having a difficult time getting permission to obtain the space that they need.

The U.S. Trustee appears to be micromanaging the chapter 13 trustee budgets, and we do not believe that this expanded role of the U.S. Trustee is appropriate. A fair method to resolve budget disputes should be adopted. The Grassley amendments provide for judicial review of unresolved budget disputes. We believe that judicial review will help ensure that chapter 13 trustees are budgeted sufficient funds to provide quality service.

On a national level, we believe that the U.S. Trustee Program should pursue two main objectives. No. 1, set basic standards for local trustees—they have a right to do that—and, No. 2, seek to minimize the costs of the U.S. Trustee operation itself.

There are problems that we perceive on a national level, and those are: No. 1, chapter 11 cases are down, and the U.S. Trustee Program has, therefore, experienced a reduction in its budget. However, the U.S. Trustee has failed to recognize this decreased workload, and, instead, they've attempted to maintain, and even increase, their bureaucracy by proposing a surcharge on chapter 13 debtors to increase their revenues.

In summary, we would urge Congress to do the following: No. 1, carefully review future budget requests of the U.S. Trustee Program, and, No. 2, approve only those funds that allow the U.S. Trustee Program to fulfill its mandated purpose. No. 3, we ask that Congress recognize the fact that the vast majority of chapter 13 trustees are doing a good job, and they don't need to be micromanaged.

Thank you very much for allowing us to provide input with regard to these issues.

[The prepared statement of Mr. Freedman follows:]

PREPARED STATEMENT OF JEFFREY M. FREEDMAN, ESQ., VICE PRESIDENT, NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

On behalf of the National Association of Consumer Bankruptcy Attorneys ("NACBA"), I would like to thank the Subcommittee for the opportunity to comment on the operation of the U.S. Trustee Program and its impact on our nation's bankruptcy system. With regard to my personal background, I began practicing law in the Buffalo, New York area in 1977, and in 1980 I opened my own law office. Since that time my firm has filed over 10,000 bankruptcy cases in western New York. I also had the experience of serving as a Chapter 7 Trustee with the Bankruptcy Court for seven years.

I am currently the Vice President of NACBA, and a founding member of its Board of Directors. Our association was formed in 1992 to ensure that the voices of consumer debtors are heard in the legislative process, and to assist consumer debtor attorneys in effectively representing their clients. In its four years of existence, NACBA has been actively involved in both federal and state legislation affecting the rights of consumer debtors. NACBA worked closely with both the House and Senate Judiciary Committees as they drafted the Bankruptcy Reform Act of 1994.

Also, through its educational seminars offered at its annual conventions, NACBA has provided an opportunity for bankruptcy attorneys to meet and learn about important developments in bankruptcy law. In addition, NACBA has participated as an *amicus curiae* in several appellate cases at the Circuit Court and one case at

the U.S. Supreme Court level involving important consumer debtor rights. Our organization currently has a membership of 600 consumer attorneys nationwide.

NACBA approaches this oversight hearing on the U.S. Trustee Program from two perspectives. First, we have a view of the program as practicing bankruptcy attorneys in communities across the country. NACBA's members normally have an indirect relationship with the regional U.S. Trustees at the local level. Our members have the opportunity to observe the relationship between the U.S. Trustee and the local Chapter 7 and 13 Trustees, as well as the impact of that relationship on the functioning of the bankruptcy system. From the "trenches," our members have observed this sometimes adversarial relationship, and we offer to your Subcommittee our insights on some of the problems which have arisen, along with our suggestions as to their possible solutions.

Second, as a national organization, NACBA has observed the operation of the U.S. Trustee Program from a broader perspective. In this regard, we offer our perceptions as to the governmental role we believe the U.S. Trustees should productively perform. This role contrasts with the expanded role which the U.S. Trustee Program has undertaken.

NACBA'S VIEW OF THE U.S. TRUSTEE PROGRAM AT THE LOCAL LEVEL

NACBA believes that there are two primary purposes to be served by a U.S. Trustee program at the local level.

1. Proper Purposes:

a. Uncover and Eliminate Fraud and Corruption

In the 1970s, the Bankruptcy Commission expressed its concern about the close relationships it believed existed between local bankruptcy judges and the trustees they appointed. The Commission was also concerned about the lack of any meaningful supervision of the operation of local bankruptcy trustees. The Commission recommended the oversight of trustees be accomplished by the establishment of the U.S. Trustee Program. While this proposal was not enacted in 1978, it was eventually adopted in 1986.

In its early years, the U.S. Trustee Program did uncover instances of fraud and corruption on the part of local bankruptcy trustees. Those trustees were removed from their positions and in many instances prosecuted. Also, all of the existing Chapter 7 and 13 trustees have either been selected by or have been under the close supervision of the U.S. Trustee Program since 1986. Instances of fraud and corruption are now a rarity, given the comprehensive and stringent financial reporting requirements for local trustees under the current program. Where fraud and corruption are uncovered today, the U.S. Trustee Program has ample resources to move quickly to eliminate it.

b. Efficient Administration of Bankruptcy Cases

The U.S. Trustee Program was also intended to speed up the administration of bankruptcy cases, particularly Chapter 11 cases and Chapter 7 asset cases. Prior to the establishment of the U.S. Trustee Program, many Chapter 11 cases and Chapter 7 asset cases languished in the courts for years without meaningful distributions to creditors. This problem almost always arose in business cases, and rarely if ever arose in consumer cases. This is due to the fact that most consumer debtors file either no-asset Chapter 7 cases or Chapter 13 repayment plans. These Chapter 13 cases have historically provided a quick and efficient method of distributing dollars to creditors.

2. Problems Created by Improper Implementation by U.S. Trustees:

Now that fraud and corruption on the part of local trustees have been virtually eliminated nationwide, the U.S. Trustee Program has attempted to justify the existing size and cost of its program by finding a different objective to pursue. That objective has manifested itself in regional U.S. Trustees second guessing the local Chapter 13 trustees on a variety of budgetary issues. While the U.S. Trustee Program has sought to justify this effort as being directed at Chapter 13 trustee "abuses", the unilateral power of regional U.S. Trustees to disapprove budget items has resulted more often in interference with Standing Chapter 13 Trustees' reasonable exercise of business judgment.

NACBA believes that the overwhelming number of Chapter 13 trustees run their operations in a conscientious and diligent manner. These trustees have also consistently attempted to fulfill their obligation to provide service to Chapter 13 debtors and creditors.

Budgetary cutbacks in Chapter 13 trustee operations mandated by regional U.S. Trustees have led to a decline in services to both debtors and creditors in certain

areas of the country. Examples of such deteriorations in service include cutbacks in phone hours, cutbacks in computer access, and elimination of photocopying of essential documents for debtors and creditors.

The U.S. Trustee Program has attempted to justify this "micro-management" of Chapter 13 trustee budgets by pointing out a few examples of unjustified budget expenses of Chapter 13 trustees. While NACBA is concerned about any unjustified expenditures by Chapter 13 trustees, we are also concerned about the cost of the U.S. Trustee Program in performing this expanded role, which was not originally envisioned by Congress.

3. Suggestions for Improvement:

NACBA believes that a fair method for resolving budgetary disputes between regional U.S. Trustees and Chapter 13 trustees must be adopted. Our association strongly supports the Grassley Amendments to S. 1559 (the Bankruptcy Technical Amendments Bill), which is pending before the Senate. The Grassley Amendments provide for a judicial review of unresolved budget disputes between U.S. Trustees and Chapter 13 trustees. Such a judicial review would only be necessary after administrative remedies have been exhausted by the parties. Furthermore, the mere existence of the possibility of judicial review will tend to encourage both parties to reach rational resolutions of their disputes. NACBA believes that such a judicial review process will help ensure that Chapter 13 trustees will be allowed to budget necessary funds to provide quality service to bankruptcy debtors and creditors.

NACBA'S VIEW OF THE U.S. TRUSTEE PROGRAM AT THE NATIONAL LEVEL

NACBA believes that the U.S. Trustee Program should pursue two primary objectives at the national level.

1. Proper Purposes:

a. Set Basic Standards for Local Trustees

As discussed above, NACBA believes that the U.S. Trustee Program should set basic standards for the operations of local trustees, with the limitations set forth above.

b. Constantly Seek to Minimize the Costs of Its Operation

As is the case with any governmental program, the U.S. Trustee Program has an obligation to the taxpayers to constantly search for ways to minimize the cost of its own bureaucracy. The Program should seek only those funds necessary to fulfill its legislative mandate.

2. Problems Created by Improper Implementation by U.S. Trustees:

Because of the decline nationwide in Chapter 11 filings, the U.S. Trustee Program has experienced a reduction in its operating budget. Instead of recognizing that the reduced number of Chapter 11 cases has resulted in a decreased workload, the U.S. Trustee Program, through the Justice Department, is at tempting to maintain and even increase its current bureaucracy by proposing anew and totally unjustified tax on Chapter 13 debtors and creditors for the purpose of raising an additional $6.2 million. Chapter 13 debtors already pay more fees through their repayment plans than are necessary to cover the cost of the program. In a time when Congress is concerned with cutting the federal bureaucracy and reducing the costs of wasteful government, it is outrageous to increase the U.S. Trustee bureaucracy on the backs of either financially distressed debtors or their creditors, who are already taking financial losses. The U.S. Trustee budget proposal also contained a request for funding to contract out reviews of professional fee applications. No justification has been shown for such a request, and any such reviews should be handled in-house.

The U.S. Trustee Program has sought to justify this proposed surcharge by claiming that many cases which previously would have been filed under Chapter 11 are now being filed under Chapter 13, due to the increased debt limits included in the Bankruptcy Reform Act of 1994. NACBA and its members have found this assertion to be groundless. Very few of the Chapter 13 cases being filed today which would have exceeded the old debt limits could ever have been filed under Chapter 11 because these debtors could not have afforded the much higher costs associated with Chapter 11. Furthermore, the U.S. Trustee Program does not require additional funds for these cases in any event, since these cases are already being administered by the local Chapter 13 trustees. To grant the U.S. Trustee Program additional funds for this purpose would duplicate the administrative functions and costs already included in the Chapter 13 process.

3. Suggestions for Improvement:

NACBA suggests that Congress carefully scrutinize future budget requests for the U.S. Trustee Program and approve only those funds necessary to allow the Program to fulfill its mandated purposes. Congress should reject efforts to increase the U.S. Trustee bureaucracy, which would come at a significant Cost to the taxpayers or the debtors and creditors involved in the bankruptcy process.

I want to thank the Subcommittee for allowing NACBA to testify on this important issue affecting bankruptcy administration. Our association has a strong interest in maintaining a fair, effective, and efficient consumer bankruptcy system. NACBA would be pleased to provide any additional input that the Subcommittee believes will be helpful.

Mr. GEKAS. Yes, and we'll have questions for you.

I want the record to show that we have been joined by two other members of the committee: the gentleman from Virginia, Mr. Goodlatte; the gentleman from South Carolina, Mr. Inglis.

We'll proceed with the testimony of Mr. Ray.

STATEMENT OF DAVID RAY, BOARD MEMBER, NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES

Mr. RAY. Good morning, gentlemen. My name, as you have said, is David Ray, and I'm an attorney, C.P.A., and panel trustee in Los Angeles, CA, which seems to be the consumer bankruptcy capital of the world. I'm here at the request of Joseph Wittman, the president of the NABT, National Association of Bankruptcy Trustees, and our thanks goes out to committee staff, especially Charlie Kern.

Chapter 7 trustees administer over 70 percent of the bankruptcy cases filed in the country. Most of the cases are consumer cases, and they go through without too much difficulty. Over 90 percent of these cases are no asset cases. When I say "no asset cases," I mean there are no assets left after exemptions and proper deductions. Therefore, the trustee has—about 5 percent of the cases are asset cases, and 1 percent of these give you 57 percent of all the assets that we deal with altogether.

The U.S. Trustee's Program, which was implemented in 1979, was to supervise, administrate, review fee petitions, file comments on fee petitions, monitor and report programs, and perform all other duties that the Attorney General suggested that they do. The NABT has had sort of a bittersweet relationship with the EOUST—that's the Executive Office of the U.S. Trustee—since its inception. We feel that the addition of Jerry Patchan to the program is a definite achievement because Mr. Patchan has listened to what the various trustees, not just the president of the board of directors, but any trustee that wants to take the time to talk to him, Mr. Patchan does talk to them, and that has been a definite help.

We feel—or at least I feel—that he could use more power with the 21 regional trustees that he's got because, frankly, the 21 regional trustees are almost running their own shops in many cases. And so, as a result, the contact that most people have with the U.S. Trustee's Office is really usually with either a staff attorney or a paralegal, and on rare occasions an Assistant U.S. Trustee.

We have the same concern that many other people have had, and has been shared by the National Bankruptcy Commission. Actually, our concerns basically fall into about five categories.

The one is the appointment of private panel trustees which serves the public interest. The second it safeguards for panel trust-

ees. The third is a uniform statute limiting personal liability of panel trustees. The fourth is employment of trustee's firm as an accountant or an attorney, and the last is the compensation structure for a trustee on a commission basis.

To get into those more specifically, there are over 1,200 individuals who serve as chapter 7 trustees. I've summarized some of their views as follows:

The trustee recognizes the authority of the U.S. Trustee to supervise their work, even if that supervision becomes burdensome or repetitive, because certainly that's the U.S. Trustee's job. However, we feel that the U.S. Trustee micromanages—and that seems to be the new term of art—what the panel trustee does and looks at his business judgment, his or her business judgment, from time to time and on a case-by-case basis. And, frankly, if the trustee doesn't play ball with the way the U.S. Trustee sees it—and when I say that, I don't mean Mr. Patchan; I mean whoever is making a decision based on what they're looking at, and it usually is an Assistant U.S. Trustee to begin with—then you get a less-than-favorable review or you're in trouble in your next annual review. It's sort of a Big Brother syndrome.

We feel that if the trustee and the U.S. Trustee disagree, they should be willing to take their disagreement to the court and let the court decide which is the proper way to do it. I shouldn't necessarily have to drop my position simply because it's not a popular one with whoever I'm dealing with at the U.S. Trustee's Office.

The other thing is that the U.S. Trustee supervises the trustees, but they spend entirely too much time on minute details, as, for example, my monthly—my 180-day review will come back and I'll have in that review that I'm abandoning something at the conclusion of the case, so I don't have to file another petition just to abandon it, and it will come back with an objection that the abandon belongs on the next line. That's, frankly, a waste of time, and then I have to go dig out the thing, go back and write a letter back to the U.S. Trustee's Office explaining this, and it's dropped at that point. And so I say they're mired down in administrative details and paperwork, and a good deal of the time that they spend is trying to justify their own position, which is not an uncommon thing with that type of a position.

The specific concerns that we're worried about are due process. In other words, there should be some way, other than just bringing back to the U.S. Trustee, the same one who's objecting to what we're doing, to protect our position. There is a Senate bill, I understand, No. 1559—I don't know whether anybody is aware of that yet—which is going to solve part of that problem and solve part of the problem with the liability, because the liability of the U.S. Trustee is egregious. In other words, when I say "the U.S. Trustee," I'm talking about the panel trustee.

What happens is that he is, in essence, sailing in the wind. I'm sorry——

Mr. GEKAS. It's all right.

[The prepared statement of Mr. Ray follows:]

Prepared Statement of David Ray, Board Member, National Association of Bankruptcy Trustees

Mr. Chairman and Members of the Committee, my name is David Ray. I am an attorney, panel trustee in Los Angeles, California and I am appearing at the request of Joseph I. Wittman, President of the National Association of Bankruptcy Trustee. The National Association of Bankruptcy Trustees appreciates the opportunity to testify before this committee on the United States Trustee Program. Our thanks go out to the Committee's staff, especially Charlie Kern.

Chapter 7 trustees administer over 70% of all bankruptcy cases filed in this country. Most of these cases are consumer cases but some are small business and corporations which have closed their doors because of financial difficulty. The trustee's job is to pick up the pieces and see if there are any assets left which can be converted to cash for distribution to creditors. Over 90% of these cases are no asset cases. By no asset, I mean that there are no assets, after exemptions and secured property, to liquidate for the benefit of credits. Correspondingly, the Chapter 7 Panel trustee spends most of their time with the 5% of the cases which constitute asset cases. In fact a 1994 GAO Report states that less than 1% of Chapter 7's generate 57% of all receipts administered by Chapter 7 trustees. It is in these small percentage of cases which trustees have distribution millions of dollars to general unsecured and priority creditors.

The United States Trustee program was implemented in 1979 in 14 pilot districts to address certain abuses perceived under the Bankruptcy Act. The UST Program went nationwide in 1986, The statute that provides the authority for the UST states the UST shall:

a. establish, maintain and supervise a panel of trustees in Chapter 7;

b. supervise the administration of cases under 7, 11, 12 or 13 including: (1) reviewing fee applications; (2) file comments regarding fee applications I (3) monitor and report all actions which constitute crimes; and (4) preform all other such duties as the Attorney General may prescribe .

The NABT has maintained a "bitter-sweet" relationship between the EOUST since its inception. This relationship has been a learning process for both. The addition of Jerry Patchan to the program is a definite achievement of the program. Mr. Patchan's addition has bolstered communications, dedication and consistency within the program.

However, the UST program is not without faults. The UST program, which is part of a multi-faceted bureaucracy consists of 21 Regional Trustees, 93 Assistant UST's and approximately another 1,000 employees across the country. Rarely does the panel trustee deal directly with his/her UST. Usually contact is with an AUST, staff attorney or par a professional.

Among the concerns that the NABT has with the UST Program are the same concerns which the NABT has shared with the Bankruptcy Review Commission. These concerns are briefly set forth below but are more fully detailed in the copy of the paper presented to the Commission some months ago which is attached as exhibit A, to this testimony. Briefly our concerns are as follows:

1. Appointment of Private Panel Trustees serves the public interest
2. Safeguards for Panel Trustees;
3. Uniform statute Limiting Personal Liability
4. Employment of Trustee's Firm as Attorney of Accountant
5. Compensation structure for trustee on a commission basis.

The details of these concerns are attached at exhibit A.

Chapter 7 trustees are a diverse group of attorneys, accountants and other business professionals. Approximately 1,200 individuals serve as Chapter 7 panel trustees. The members of NABT have diverse views regarding the UST program. I have summarized some of these views below which have been expressed by our members:

a. The UST and the panel trustee co-exist fairly well. While problems may come up from time to time, they are usually worked out with good communication between the UST and panel trustee. The trustee recognizes the authority of the UST to supervise their work, even if that supervision becomes burdensome or repetitive.

b. UST micro-manages the panel trustee and imposes his/her business judgment from time to time on a case by case basis. In some instance they try to be "judge and jury" indicating that if the trustee does not "play ball" the trustee may find a less favorable review or trouble in their next annual review. The "Big Brother" syndrome is common place.

c. UST fills a necessary role in supervising the administration of bankruptcy cases. Where the trustee and the UST disagree, both are willing to take their dispute to court and abide by the outcome. The panel trustee recognizes that

the UST must Supervise trustees but disagrees with how the supervision occurs. The UST spends too much time on minute details of cases which impedes the business judgment of the panel trustee.

d. UST program is mired down in administrative details and paper work. While there may be some value in monitoring fraud and criminal activity in bankruptcy cases, the rest of the time they spend trying to justify them self. For instance, they spend too much time reviewing the reports and pleadings in Chapter 7 cases, when they should only be involved with whether the trustee is moving the case along efficiently and accounting for all of the assets.

Again, these views represent differing views of our members across the country. The NABT supports the efforts of the UST to monitor and improve the administration of bankruptcy cases. NABT recognizes the authority and need for supervision of panel trustees. However, there are various concerns which NABT has with the supervision of trustees that need to be brought to the Committee's attention. These are not listed in any particular order, except for the first one. Some of these are intended to elicit dialogue regarding concerns that trustees have expressed:

Due process or some type of grievance procedure to address retention, suspension or removal issues. Trustees are appointed to one year terms. Yet they serve at the discretion of the UST until the UST decides to removal, suspend or not renew their appointment. There are no hard and fast standards by which trustees are evaluated that are applied uniformly across the country. Each UST is allowed wide discretion in the retention, suspension and removal of trustees.

The UST, under Mr. Patchan, does have a method of "internally" taking a look at an aggrieved trustee, if the trustee does not get a fair shake from his AUST or UST. This problem can be referred to the Office of Oversight in the EOUST Office. However, this procedure is internal and there is no automatic right of review by an "independent" body, such as a court. To date the EOUST has not recognized that a panel trustee has any right to an independent review, or access to the APA or the courts.

Micro-management by UST personnel. Panel trustees get bombarded by numerous requests from UST personnel on minute and trivial matters which are within the independent business judgment of the panel trustee. The focus of the UST has become too "fly specked" in reference to panel trustee performance. The real questions should be: Why is the case still open? and Are all of the assets properly accounted for?

Term of appointment. Panel trustees currently serve one year terms which are then reviewed annually by the UST to determine whether the appointment will be renewed. The appointment is terminal at will of the UST. While this issue relates to the Due Process issue, it relates to the time and investment that the panel trustee puts into the business of being a panel trustee. Most trustees commit countless time, money, resources to "underwrite" their trustee practice since it takes time to get it going and see the benefits of your efforts. If the UST removes "at will" this has a chilling effect on retaining good qualified trustees.

Trustee Liability. Trustees can sue and be sued under the law. However, trustee has unlimited liability potential in environmental, tax and other types of instances. In some instances the trustee is sued by an angry debtor and has to use his/her time, money and resources to defend these actions which have little or no merit. Should the trustee have some type of limited or quasi judicial immunity? What form should that immunity take? If the trustee is sued, can he use estate assets to defend such actions? (See exhibit B for a detailed article.)

Trustees are not given copies of their annual evaluations. Some UST's provide the panel trustees with copies of their evaluations. Some do not and others are offended if they are asked to provide the same. However, this is the evaluation which determines whether the trustee's appointment is renewed. Also, the contents of the evaluation may contain information which the trustee can use or information which the trustee can correct, if there are errors. The EOUST has no policy requiring UST's to provide these evaluations. Rather the EOUST provides that the UST should provide a "summary." A summary is not sufficient, where an individual is being evaluated, and that evaluation bears on future renewal of the appointment or other matters.

Trustees are paid on a Commission basis, not an hourly fee basis. With the enactment of the 1994 Bankruptcy Amendments, the EOUST has set out national guidelines for fee review in their office. These guidelines are applicable to trustee fees which a trustee applies for in a case. Under 11 USC 326, the law sets a "maximum" "commission" which the trustee may receive in a case. Prior to 1996, most trustees usually received this maximum commission. After

the adoption of the UST Fee Guidelines, more trustees are seeing that their fee applications are undergoing closer scrutiny. One of the main factors which is being used by the UST is what is the "effective hourly rate" given the amount of time the trustee spent on the case in relation to the total amount of fees requested. This type of analysis, effectively makes the panel trustee a "hourly rate" professional, as opposed to a commission based, one as set out in the law. Essentially, if the trustee uses his/her expertise, connections and know how to obtain a fantastic result with minimal time expended, the trustee is penalized. Such a concept penalizes the efficiency and condones "sloth."

Uniform versus a non uniform UST Program. The UST Program has at least 21 different faces across the country. Within those 21 regions, their is even more differences. The EOUST has vested each UST with vast management authority and responsibility. In some areas, this management authority is being misappropriated. In some areas, the UST is not in touch with what the AUST's are doing and in others the AUST's or other staff may be exceeding their authority. For example, In Kansas, a panel trustee was called by a par a legal and told that the applications to employ professionals and corresponding orders were not being submitted properly. The par a legal was told by the trustee that the trustee was complying with the Local Bankruptcy Rule on the submission of such pleadings. The paralegal told the trustee that the trustee's practice did not conform to the UST policy and such would be pointed out to the paralegal's superiors.

While this instance, may seem insignificant, it is not. If you multiply this instance by 1,000 trustees times 800 UST staff which contact trustees, you end up with 800,000 types of scenarios which have been played out across the country.

These examples, are a smattering of the concerns, issues, questions and unaddressed areas which panel trustees deal with on a day to day basis. A panel trustee is a *fiduciary*. Ultimately, the panel trustee has to justify all his/her actions to any objecting the party, whether that is the UST, the court or a creditor. All of these concerns impact on the ability of the panel trustee to be a *fiduciary* and fulfill his/her responsibility to respond to their duties under the law.

EXHIBIT A

THE BANKRUPTCY CODE
AREAS FOR CONSIDERATION FOR THE BANKRUPTCY REVIEW COMMISSION

The National Association of Bankruptcy Trustees ("NABT") is an organization of approximately 900 panel trustee members, and other individuals who share the common interest of improving the quality of trustee practice, thereby improving the efficiency of the entire bankruptcy process. NABT has testified before Congress on matters effecting the bankruptcy process, and was actively involved in the October 22, 1994 Amendments to the Bankruptcy Code.

NABT recognizes that many well-established principles and procedures will be reviewed by the Bankruptcy Review Commission, many of which directly affect the practices of bankruptcy trustees. The association encourages the review of the particular issues referred to below, and stands willing to appear at any hearings connected with changes in these areas, or to submit supplemental position statements on these issues.

1. **APPOINTMENT OF PRIVATE PANEL TRUSTEES SERVES THE PUBLIC INTEREST-** The appointment of private trustees in all chapter 7 cases provides an unparalleled level of service to the public and carries out the intent of the Bankruptcy Code efficiently and economically. The system works at no cost to the United States government, and there is no need to change this aspect of the Bankruptcy Code.

The average panel trustee has served 11.4 years as trustee in more than 4400 cases. The overwhelming majority of trustees hold college degrees and most hold graduate degrees as well. Most of these practitioners are attorneys, most of which have considerable experience in the bankruptcy arena.

Other than the expertise which the panel trustee brings to a bankruptcy case, the structure of the Bankruptcy Code provides that trustee with the requisite motivation to investigate the debtor adequately, and to expend the necessary time to uncover hidden assets for the benefit of creditors.

Furthermore, the panel trustee acts as the caretaker of the interests of numerous secured creditors during the first few weeks of the case, and also has the responsibility for assuming or rejecting executory contracts timely, and reviewing and objecting to the exemptions of the debtors if they are in violation of applicable exemption statutes.

The suggestion that the entire function of the panel trustee could be performed by the U.S. Trustee's office, or some other governmental agency is without merit. Such an agency would lack the requisite motivation and experience to uncover hidden assets, and to investigate the debtor completely. Potential assets would be overlooked, and possible avoidance actions would not be pursued, because of the contingency of the outcome. Other time sensitive matters, such as assumption of executory contracts and objections to exemptions, might not be timely considered, and bankruptcy estates could suffer therefrom.

The creditor community has continually supported the role of private trustees in chapter 7 cases and those creditors recognize that the experience of the private trustee has generated significant recoveries in chapter 7 proceedings. In a typical year, Chapter 7 trustees, as representatives of their estates, closed over one-half million cases, and distributed $590,000,000 to secured and priority claimants, $146,000,000 to prepetition unsecured creditors, $182,000,000 to administrative claimants, and returned $26,000,000 to equity owners. It is highly unlikely that any governmental agency could produce equivalent results, particularly without the motivation which the Bankruptcy Code provides to panel trustees.

2. **SAFEGUARDS FOR PANEL TRUSTEES** – Under the current system, the panel of trustees is created by the United States Trustee, and appointments are made to each case by the U.S. Trustee's office or the bankruptcy administrator. Recently Chapter 7 trustees have dealt with the Chapter 7 initiatives, promulgated by the Office of the United States Trustee, which has significantly increased the paperwork, workload, reporting requirements, and overhead expenses of all trustees.

While most Chapter 7 trustees have adapted to the additional reporting requirements, these initiatives have amplified the commitment which must be made by a Chapter 7 trustee in order to continue on the panel. Most trustees have administrative assistants to assist them in administenng their case load, and most offices now have incorporated computer programs to help with the reporting requirements. All of these changes have

required a trustee to commit his or her resources and time for the long term role of serving as a panel trustee.

However, the U.S. Trustee currently appoints panel trustees for one year terms, and the statute does not specify any rights of trustees to reappointment. Some trustees in the country have been subject to suspension from rotation (receiving new cases) and other trustees have been removed totally from the panel, with little or no notice from the U.S. Trustee's office, and without any opportunity to retain their position, or to receive an explanation from the U.S. Trustee concerning the reason for their removal.

NABT believes that, in order to secure the continued expertise of panel trustees that have the experience and resources to adequately administer Chapter 7 cases, those trustees must be given adequate security for their continuing role as a panel trustee, such that the investment of time and resources can be deemed justified.

NABT believes that the appointment of trustees to a Chapter 7 panel should not be limited to a one year term, and that adequate protection should be given to the trustee, such that removal from the panel (except in instances of misconduct) should be limited to those situations where the trustee has had an adequate opportunity to present a case to a competent tribunal, and to have the removal of a trustee from the panel subject to further review by the courts, if necessary.

3. **UNIFORM STATUTE LIMITING PERSONAL LIABILITY OF TRUSTEES** – Following the enactment of the Bankruptcy Code, courts have taken different directions with regard to the personal exposure of the trustee for actions taken in a fiduciary capacity. Some courts have held that a trustee is liable for any intentional or negligent violation of the duties imposed by law. Other courts have found that the trustee has an "absolute quasi-judicial immunity from damages", and other courts have held that a trustee is only liable if the actions taken exceed his or her authority, as conferred by statute or the court. In some districts, trustees have an absolute immunity when they act pursuant to court order.

NABT acknowledges that personal liability should be imposed when the trustee acts in an intentional way in violation of statute or court's orders. However, trustees should be provided immunity for actions which are not willful or deliberate.

Trustees are often faced with situations where the facts are not available, such as when a petition is first filed, and the statements and schedules have not yet been prepared. It is not fair to impose the risk of personal liability on a trustee who may not even be aware that a dangerous situation exist, or that assets (encumbered or otherwise) may be uninsured. Panel trustees need some protection, particularly in cases where circumstances are beyond their control, or where there are no liquid assets to cover expenses of repairs insurance, etc.

4. **EMPLOYMENT OF TRUSTEE'S FIRM AS ATTORNEY OR ACCOUNTANT** – Under the current system, trustees are allowed to hire themselves, or their own firm, as a professional under 11 U.S.C. §327. However, some courts in this country refuse to allow some trustees to retain themselves, and require the appointment of outside counsel. NABT opposes this position, and urges the commission to reemphasize the clear meaning of the current law, which specifically authorizes such practice.

The trustee, in hiring his or her own firm, has available known quantities of legal talent. The trustee is competent in bankruptcy. Otherwise, the trustee would not have been appointed to the panel by the United States Trustee. The trustee is entitled to the best counsel available, and that counsel may well be the trustee's own firm.

Furthermore, trustees are often placed in a position of pursuing contingent causes of action, for which compensation will not be available to counsel unless there is a successful result. The trustee would be unable to pursue these causes of action, unless the trustee's own firm was willing to underwrite the representation in the time and money needed. The inability to obtain legal representation outside the trustee's own firm would severely reduce the number of dollars presently being collected and distributed by trustees.

Even if the trustee were able to obtain outside counsel in most cases, those attorneys would be either (1) novices, who believe that there was easy money to be made in representing trustees, but who become quickly disillusioned, (2) smaller firms wanting to expand their bankruptcy practice, but subsequently recognizing that the contingent nature of such cases does not justify the risk, (3) large firms who represent big Chapter 11 proceedings, who usually overwork the case and charge the trustee many times more than the lawsuit justified, by the use of supplemental attorneys, paralegals, and assistants, or (4) other trustees of the

Chapter 7 panel, which would then create an unattractive "bankruptcy ring." These alternatives are not in the best interest of most bankruptcy estates, and the trustee should not be restricted from hiring the best firm at his or her disposal, which might well be the trustee's own firm.

5. COMPENSATION STRUCTURE FOR TRUSTEES ON A COMMISSION BASIS -- Under the current system, a trustee is entitled to a reasonable fee, not to exceed certain percentages which are set forth in 11 U.S.C. §326. In most Chapter 7 proceedings, trustees receive the maximum statutory amount allowable, and the difference between the "reasonable" fee, and the "statutory percentage," is not discussed.

However, recent decisions by some courts, as well as various positions taken by the U.S. Trustee, indicates that the statutory percentage is only a maximum, and trustees maybe held to more "subjective" review in determining the amount of their trustee's fee. Some courts have even reviewed the trustee's function from an hourly basis, which then requires the trustee to maintain and submit detailed time records in each case.

This has created a situation of inconsistent decisions throughout the country, and confusion among trustees as to whether they will be entitled to a statutory percentage of the funds disbursed in a case, or whether they will be paid on an hourly basis. Since trustees often work on a "contingent" fee basis, such that their ability to receive any trustee's fee requires the discovery of assets, or avoidance of transfers through a large expenditure of time and expense on the part of the trustee, the restriction of the allowable trustee's fees, based on time spent, eliminates the risk/reward incentive for the trustee to pursue these matters. Trustees will be much less likely to pursue a contingent preference action, if they feel that their fees will be subsequently challenged based on the time incurred in the case as trustee. Furthermore, all trustees have been placed in the position of pursuing assets and causes of action, which result in no distribution and no recovery, and hence no fees are ever received by the trustee. Requiring the trustees to be limited by a maximum statutory amount would be acceptable, if the trustee were able to evaluate the risk/reward of pursuing contingent assets at the outset of the case. However, when that statutory's percentage is subject to substantial reduction, the reward often does not justify the risk.

NABT believes that trustees should be compensated in a similar manner to auctioneers and real estate agents who receive a percentage of the funds received from the administration of the assets. The statutory allowance and the percentages currently in place can be maintained, but the formula should not be subject to the extensive variances which have developed between different jurisdictions since the enactment of the Bankruptcy Code.

6. RIGHTS IN CONVERSION TO AND FROM OTHER CHAPTERS -- Under the current system, a Chapter 7 trustee is often "handcuffed" by actions which have taken place in a prior Chapter 11, 12 or 13 proceeding. One such problem was recently addressed in the 1994 amendments, which allowed a Chapter 7 trustee, in a case converted from Chapter 11 between one and two years after filing, a full one year from appointment to commence avoidance actions. However, this one change does not solve the problem.

If a prior case under Chapter 11, 12 or 13 converts to Chapter 7 after two years, the trustee has effectively lost all rights to pursue avoidance actions. If no one objected to the debtors exemptions in the preconversion case, the trustee may not have the right to object to exemptions, even if they exceed statutory maximums. Also, Chapter 11s are often not monitored, such that the Chapter 7 trustee is left with an incredible burden of Chapter 11 administrative expenses, such that an eventual distribution to unsecured creditors becomes impossible.

Problems also exist in cases where debtors convert their cases from Chapter 7 into Chapter 11 or 13, in order to defeat the trustee's pursuit of an action which adversely affects the debtor. This often occurs where the Chapter 7 trustee has sought to deny the discharge of the debtor, or is seeking to avoid preferential transfers or fraudulent conveyances which affect family or friends of the debtor. In other circumstances, unperfected security interests could prevent the debtor from retaining possession of assets, which would be subject to liquidation by the Chapter 7 trustee.

While the Chapter 7 trustees do not always contest the conversion of cases from Chapter 7 to Chapter 11 or 13, since this often provides for improved disbursement to unsecured creditors and is also good public policy to encourage debtors to pay their debts, trustees are often punished in such cases, by the disallowance of any trustee's fee based on the work performed. (Most courts deny the trustee any compensation unless funds have actually been received and disbursed by the trustee.) NABT believes that trustee's fees should be

awarded to a Chapter 7 trustee upon conversion from Chapter 7, based on the reasonable value of the assets which would have been recovered and disbursed to creditors in the Chapter 7 proceeding. In the alternative, the Chapter 7 trustees' fee could be based on the disbursements made in the subsequent Chapter 11, 12 or 13 plan.

7. OTHER MISCELLANEOUS ISSUES OF CONCERN TO NABT -- Chapter 7 trustees are also concerned about other substantive provisions of the Bankruptcy Code. The trustees recognize that they are responsible for administrating the substantive provisions of the Bankruptcy Code, not legislating them. However, NABT makes the following observations concerning certain substantive portions of the Bankruptcy Code for consideration by the Commission:

a. Diminution of assets for a trustee to administer -- Recently, more and more assets are slipping through the hands of trustees. The primary culprit is exemptions, both under state statutes, and under other federal authority. It is not uncommon to have debtors file proceedings with trust, pension funds, IRAs, or other entitlements in excess of $50,000, which are totally exempt from administration by the bankruptcy estate (even though such funds could pay a substantial percentage, if not all, of the obligations owed by the debtor. In an addition, state statutes dealing with tenants by the entirety and other co-ownership laws, often render it difficult to liquidate any value for the benefit of creditors, because the restrictions of §363(h) prevent a sale of the effected property. Trustees also have difficulty with inheritances which, although becoming property of the estate within 180 days after the filing of the petition, are never disclosed to the trustee, and hence are never administered. NABT encourages the commission to review the exemptions scheme within the bankruptcy process and to recommend appropriate changes which would make the application of exemptions more consistence between the various states, and also prevent the abuse of the bankruptcy process when a debtor exempts an exorbitant amount of property.

b. Expansion of priority claims reduce distribution to unsecured creditors -- Under §507, there are currently nine different priorities for the distribution of funds from the bankruptcy estate; the 1994 amendments increased the priority to include claims for debts to a spouse, former spouse, or child for alimony or child support, and expanded the dollar maximums for wages and sales commissions. In addition, tax claims often consume the entire distribution of funds from a bankruptcy estate, even though the Internal Revenue Service holds a nondischargeable claim which can be collected from the debtor outside the bankruptcy process. (This results in the trustee administering the case, liquidating assets, for the indirect benefit of the debtor, since nondischargeable obligations are paid as a result.) Although NABT does not assert that any particular priority should be eliminated, trustees are concerned about the effect that these priorities have on the potential distribution to unsecured creditors, and would encourage the commission to review these priorities, in order to provide the general unsecured creditors with a better opportunity for some distribution from bankruptcy estates.

c. Role of §341 hearings -- NABT believes that the meeting of creditors, pursuant to §341, should be retained as part of the bankruptcy process. Although the hearings are often uneventful, these meetings are, sometimes, the only exposure that a debtor has to the bankruptcy courts. The appearance of debtors at these hearings helps to make them full aware of the actions they are taking, and adds some formality to a process which could otherwise be handled exclusively from an attorney's office.

The §341 hearing also provides the panel trustee with an excellent opportunity to evaluate the case, investigate the debtor, determine the creditability of the debtor, and to determine whether any action can be taken to generate assets into each bankruptcy proceeding. These hearings often are the focal point of the entire proceeding, and provide creditors, as well as the debtor, with a forum within which to resolve differences.

d. Purpose of discharge hearing -- NABT does not believe that the discharge hearing serves any practical purpose in bankruptcy proceedings. Many districts have completely eliminated the discharge hearing, other districts have streamlined the process or modified it, such that the debtors never receive any true benefit from the hearing. The information given to debtors at the discharge hearing consists of advise which should have been already given by counsel to the debtor, and does now also included in a

written statement given to all debtors at the §341 hearing (prepared by the U.S. Trustee) which, in essence, explains the same concepts.

e. Tax issues -- The interrelation between the Internal Revenue Code and the bankruptcy code is confusing and overly burdensome. Few attorneys, accountants or trustees understand all of the statutes involving the taxation of bankruptcy estates, and the trustee's responsibility for preparing and filing tax returns under different circumstances. Trustees also face the danger of liquidating assets with considerable equity, only to discover that the debtor's basis in that property was low, and that the capital gains tax generated by the sale of the asset consumes all (and sometimes more) of the proceeds from the sale. Trustees are often requested (or directed) to file tax returns in no asset cases, where there are no funds to pay accountants or to cover the costs incurred by the trustee in preparing such returns. NABT believes that the taxation of bankruptcy estates, and the duties of trustees with regard to the filing of tax returns under appropriate circumstances, should be reviewed, clarified, and amended, where appropriate, in order to insure that trustees will have clear guidelines within which to perform their statutory duties, and hopefully to prevent the "swallowing" of all of the assets of an estate by a capital gains tax which discourages trustees from attempting to liquidate the asset in the first place.

In conclusion, NABT would like the opportunity to be involved in the work of the bankruptcy review commission, and to address the concerns outlined above, as well as any other issues which effect trustees and their practices. We look forward to working with your commission and the development of recommendations which will improve the bankruptcy process for all parties concerned.

EXHIBIT B

IS MERE NEGLIGENCE ENOUGH? A DISCUSSION OF THE STATUS OF DERIVED JUDICIAL IMMUNITY FOR BANKRUPTCY TRUSTEES

By

David W. Allard, Esq.
of
Allard & Fish, P.C.

I. INTRODUCTION - THE BANKRUPTCY CODE AND RULES

> In this cold cruel world, infants and incompetents may be sued; charitable institutions may be sued; doctors and hospitals may be sued; municipal, school, state, federal and foreign governments and their officials may be sued; and, worst of all, judges may be sued. Chapter 7 trustees possess no special immunity from one of life's less pleasant experiences, and no compelling reason has been shown why one should be created at this time.

In re Reich, 54 B.R. 995, 997 (Bankr. 1985). While the Bankruptcy Reform Act of 1994 (the "1994 Reform Act") provided no relief on the issue of personal liability of Bankruptcy Trustees, at least two Federal Judicial Circuits currently follow cases which forthrightly state that trustees have derived judicial immunity. The Standard has been set in the Fifth Circuit by Boullion v. McClanahan, 639 F. 2d 213, 214 (5th Cir. 1981) and in the Eighth Circuit by Smallwood v. United States, 358 F. Supp. 398 (E.D. Mo.) aff'd, 486 F.2d 1407 (8th Cir. 1973). Five other circuits including the Sixth Circuit (see Ford Motor Credit Co. v. Weaver, 680 F. 2d 451, 461-62 (6th Cir. 1982) have generally found bankruptcy trustees liable only for willful and deliberate violations of the law outside the scope of authority granted by statute (despite the decision of bankruptcy court in Reich, *supra*).

While only four circuits have found personal liability for mere negligence of bankruptcy trustees, compelling reasons exist for the legislature to create a uniform statute providing immunity for bankruptcy trustees. When In re Tremont Corp., 143 B.R. 989 (Bankr. W.D.N.Y. 1992), ruled that a bankruptcy trustee was not subject to Rule 11 sanctions, it brought into focus some of the features that distinguish bankruptcy trustees from other types of plaintiffs (as well as other interested parties). It declared at page 990, as follows:

> 1. They are successors in interest to the debtor, with no first-hand knowledge of the facts underlying complaints that arise out of bankruptcy events.
>
> 2. Those non-parties with first-hand knowledge may be hostile and even (as here) a person convicted of making false statements about his finances. Some may personally benefit from concealing facts from the Trustee.
>
> 3. They may be personally liable (in some districts) for even slight negligence in failing to prosecute a cause of action that is an asset of their trust.
>
> 4. The two-year Statute of Limitations of 11 U.S.C. §546 may be far shorter than the period of time that the debtor had in which to decide whether to pursue the cause before the filing of the petition.

In fact, the recently enacted 1994 Reform Act actually shortens the Statute of Limitations of 11 U.S.C. §546 to the later of two years after the entry of the order for relief (not the appointment of a trustee) or one year after the appointment or election of the first trustee. Furthermore, increases in compensation granted by this

new amendment under 11 U.S.C. §326 and 330 do not provide sufficient income for trustees to offset the increased risks created by the shorter Statute of Limitations alone.

Bankruptcy trustees themselves know that they hold unique positions with unique problems, but this knowledge is apparently not widely held by others. Bankruptcy trustees who serve in Chapter 7, 11, 12 and 13 proceedings, taken as a whole, are a very small group numbering less than three thousand people, including inactive trustees who are not currently receiving new cases. Unfortunately, bankruptcy trustees enjoy no significant, political "clout" despite the fact that Chapter 7 trustees alone distribute to creditors approximately one billion dollars annually. Reflecting their small numbers and political impotence, the United States Bankruptcy Code (the "Code") defines the role of a trustee regarding the issue at hand by simply stating at Section 323(b): "The trustee in a case under this title has capacity to sue and be sued."

Collier on Bankruptcy reports only that this provision is a logical adjunct to the duties to be performed by trustees (as listed in Sections 704, 1106, and 1302 of the Code) and refers to Rule 6009 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). Bankruptcy Rule 6009 merely expands on the trustee's authority to defend any pending action or proceeding by or against the debtor or to commence and prosecute any action or proceeding in behalf of the estate before any tribunal. See 8 COLLIER ON BANKRUPTCY §6009.03 (15th Ed. 1993). Collier, *supra*

35-307 O - 96 - 3

also provides the first reference researchers will find to personal liability of trustees as follows: "The trustee appears in his or her legal capacity and is entitled to DERIVED JUDICIAL IMMUNITY." (Emphasis added).

What is derived judicial immunity? Where is it found? When does it protect bankruptcy trustees? The concept is not found in the Code or the Bankruptcy Rules. Is it possible that Congress just overlooked a subject of such importance? Surely other federal statutes protect our modestly paid, highly qualified, select group of trustees who may be fiduciaries for every interested party in a case and others as well! The Supreme Court of the United States references a Treasury Regulation relevant to this discussion, in a federal tax case involving a Chapter 11 trustee. Holywell Corp. v. Smith, 112 S. Ct. 1021 (1992). The term, "fiduciary," is defined as follows: "'Fiduciary' is a term which applies to persons who occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators . . . ." 26 CFR §301.7701.6). Numerous cases have found that trustees occupy positions of peculiar confidence as fiduciaries for the debtor and all creditors, whether secured or unsecured, administrative, priority or otherwise, (*See e.g.* In re Allen B. Wrisley Co., 133 F. 388, 390 (7th Cir. 1904), *cert. denied;* sub. nom. Central Commercial Co. v. Chicago Title & Trust Co., 197 U.S. 622 (1905); In re Cochise College Park, Inc., 703 F.2d 1339 (9th Cir. 1983); In re Woodmar Realty Co., 294 F.2d 785 (1961) *cert. denied* 369 U.S. 803; Henry Ansbacher & Co. v. Klebanow, 362 F.2d 569 (2nd Cir.

1966); Fore Improvement Corporation v. Selig, 278 F.2d 143 (2nd Cir. 1960); In re Peckinpaugh, 50 B.R. 865 (Bankr. N.D. Ohio 1985); In re Nadler, 8 B.R. 330 (Bankr. E.D. Pa. 1980); In re Whet, Inc., 750 F.2d 149 (1st Cir. 1984); Commodity Futures Trading Com'n v. Weintraub, 471 U.S. 343 (1985), on remand 776 F.2d 1049; Matter of Johnson, 55 B.R. 800 (Bankr. E.D. Va. 1985); In re Redman, 69 B.R. 27 (Bankr. D. Hawaii 1986).

Bankruptcy trustees must often make difficult decisions which unavoidably disturb or dissatisfy the debtor or some specific class of creditors. Therefore, it is not uncommon to find trustees being sued by secured creditors who also routinely refuse to agree to surcharges for trustee services or expenses, by one or more unsecured creditors who disagree with the difficult decisions made by a trustee, and even third parties who are not officially "interested parties" in a case but who foreseeably may be harmed by a trustee's actions. Just as inequitable but more common, are suits against trustees by debtors who are often engaged in an openly hostile, adversary relationship with trustees, who are prohibited from enjoying compensation on amounts disbursed to the debtor! (11 U.S.C. §326(a)).

II. OTHER FEDERAL STATUTES -

A. 28 U.S.C. §959(a)

A search for other federal statutes reveals only one which provides a modicum of protection. 28 U.S.C. §959(a) states as follows:

> Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

At first glance, one might believe that this statute gives unbridled authority to sue a trustee without leave of court. However, case law makes it clear that this section actually provides a limited exception to the common law rule that leave to sue trustees must first be obtained from the court appointing them. The exception to obtaining leave arises only when a trustee is "carrying on business" connected with property of the estate. *See* In re American Associated Systems, Inc., 373 F. Supp. 977 (E.D. Ky. 1974) which declared that commencement of a suit by a trustee for recovery of sums due bankrupt is commanded by statutory directive to liquidate the estate and is not classifiable as "carrying on business." *See also* Matter of Campbell, 13 B.R. 974 (Bankr. D. Idaho 1981) in which a bankruptcy court enjoined an action against a trustee to determine liability for actions taken in the administration of the estate. *See also* Matter of Burstein - Applebee Co., 32 B.R. 504 (Bankr. W.D. Mo. 1983), which recognizes the aforementioned common law rule.

B. 28 U.S.C. §959(b) states as follows:

> Except as provided in section 1166 of title 11, a trustee, receiver of manager appointed in any cause pending in any court of the United States, including a debtor in

> possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

In re Markos Gurnee Partnership, 182 B.R. 211, 227, 228 (Bankr. N.D. Ill. 1995) is an important new case which discusses both the common law and the statutory background of bankruptcy trustee liability and defenses. It held that while a bankruptcy estate is liable to comply with nonbankruptcy law under the aforementioned statute a bankruptcy trustee cannot be held personally liable for mistakes in business judgment when acting pursuant to court order or other statutory duty. It noted that this statute did not provide for personal liability for failure to abide by its provisions. The court also found that a Chapter 11 operating trustee not only was not liable for his failure to pay state sales taxes collected during the operation of a hotel and restaurant as recurred by state law, but that he had a duty not to pay the taxes in full since their was a possibility that there would not be sufficient funds to pay all administrative claims in full as required by Section 507(a)(1) of the Code. However, illustrative of the confusion surrounding these difficult issues, the court also stated that the trustee may make payments to administrative creditors, including taxing authorities, in the

ordinary course of business. Perhaps rulings such as this will be further bolstered by 28 U.S.C. §960 which provides as follows:

> Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Yet, no United States statute anywhere squarely addresses the issue of immunity for bankruptcy trustees.

III. IN RE DELOREAN MOTOR COMPANY

A. THE BARTON DOCTRINE

A landmark decision in the Sixth Circuit Court of Appeals reaffirmed the common law rule that leave to sue trustees must first be obtained from the court appointing them. This rule is known as "the Barton Doctrine." (Barton v. Barbour, 104 U.S. 126 (1881)). In re Delorean Motor Company, 991 F.2d 1236, 1240 (6th Cir. 1993) stated as follows:

> It is well settled that leave of the appointing forum must be obtained by any party wishing to institute an action in a nonappointing forum against a trustee, for acts done in the trustee's official capacity and within the trustee's authority as an officer of the court. In re Baptist Medical Center, 80 B.R. 637, 643 (Bankr. E.D.N.Y. 1987) (citing Barton v. Barbour, 104 U.S. 126, 26 L. Ed. 672 (1881); Leonard v. Vrooman, 383 F.2d 556, 560 (9th Cir. 1967), cert. denied, 390 U.S. 925, 88 S. Ct. 856, 19 l. Ed. 2d 985 (1968); Vass v. Conron Bros. Co., 59 F.2d 969 (2d Cir. 1932); In re Campbell, 13 B.R. 974 (Bankr. D. Idaho 1981)).

> > A suit therefore, brought without leave to recover judgment against a receiver for a money demand, is virtually a suit the purpose of which is, and effect of

> which may be, to take the property of the trust from his hands and apply it to the payment of the plaintiff's claim, without regard to the rights of other creditors or the orders of the court which is administering the trust property. We think, therefore, that it is immaterial whether the suit is brought against him to recover specific property or to obtain judgment for a money demand. In either case leave should be first obtained.
>
> Barton, 104 U.S. at 129. This requirement enables the Bankruptcy Court to maintain better control over the administration of the estate. As previously stated and contrary to statements in the Bankruptcy Court's opinion, this requirement arises not from Section 959, but from the common law. Section 959 serves only as a limited exception to the above-described rule (the "Barton Doctrine"), allowing suits against the trustee for actions taken while "carrying on business."
>
> This exception does not apply to suits against the trustee for actions taken while administering the estate. In re Campbell, 13 B.R. at 976. "Merely collecting, taking steps to preserve, and/or holding assets, as well as other aspects of administering and liquidating the estate, do not constitute 'carrying on business' as that term has been judicially interpreted." Id. (citations omitted).

Additionally, the United States Bankruptcy Appellate Panel of the Ninth Circuit has recently confirmed "...that leave to sue the trustee is required to sue in those federal courts other than the bankruptcy court which actually approves the trustee's appointment." (In re Kashani, 190 B.R. 875, 885 (9th Cir. BAP 1995), *aff'd* 53 F.3d 338. This court also concluded earlier in the

case the more well known principle of common law that leave must be obtained to sue a trustee in the state court as well.

B. EXTENSION OF THE <u>BARTON</u> DOCTRINE TO TRUSTEE'S COUNSEL

The Sixth Circuit also stated,

> "[W]e hold, as a matter of law, counsel for trustee, court appointed officers who represent the estate, are the functional equivalent of a trustee, where as here they act at the direction of the trustee and for the purpose of administering the estate or protecting its assets."

<u>Delorean</u>, *supra* at page 1241. It declared that the protection that the leave requirement affords the trustee and the estate would be meaningless if it could be avoided by simply suing the trustee's attorneys. The Court unequivocally stated at page 1241 that: "... leave of the Bankruptcy Court must be granted before a suit may be brought against counsel for trustee, in their capacity as counsel for trustee, since such suit is essentially a suit against the trustee." See also related decisions regarding suits against a debtor's attorney <u>In re Balboa Improvements, Ltd.</u>, 99 B.R. 966, 970 (9th Cir. BAP 1989) which cites <u>Matter of Campbell</u>, *supra*. A very recent decision in the Michigan Court of Appeals, <u>Beaty v. Hertzberg & Golden, P.C.</u>, 543 N.W. 2d 5 (Mich. App. 1995) considered the standing of a Shareholder of a Debtor Company to sue the trustee's attorney in malpractice, and found that "The duties of the trustee's attorney are "equivalent" to those of the trustee." It held . . ."the shareholder to stand in the shoes of the trustee to maintain a malpractice action against the trustee's

attorney "for the benefit of the estate." However, the minority opinion states that this decision was flawed because the shareholder maintained the action on the basis of equitable subrogation which cannot be established by voluntary payment. In any event payment by the shareholder of all the claims of creditors, voluntary or not, present unusual facts unlikely to occur in the future. Additionally, it is puzzling why the court did not consider the normal relief proposed by the trustee of appointing a successor trustee to consider pursuit of the matter without any concern for the conflict of interest raised by the court.

Logic dictates that the DeLorean, *supra* decision will be extended to accountants and other professionals employed by the trustee. It also closes the "back door" to suits against a trustee who employs himself or herself as a professional in a case (except in rare circumstances such as Beaty, *supra*) and greatly enhances the ability of an aggressive trustee to employ competent professionals to assist the trustee in difficult and complicated cases. Underscoring the importance of this decision, the court also ruled that the trustee was entitled to recover actual damages including costs and attorneys' fees and administrative expenses, if any, by way of indemnification. Additionally, the Court ruled that the trustee clearly stated a claim upon which relief may be granted with respect to a Section 105(a) injunction against an action.

Although this decision failed to make any distinction between trustees who are sued in their individual capacity as opposed to

those who are sued in their representative capacity (perhaps intentionally), it did reduce the likelihood that a trustee will have to defend himself in state courts all over the country. In this case and others like it in which a trustee may be required to file and defend suits in many different jurisdictions, this opinion will also reduce the likelihood that a trustee will be subjected to widely varying standards of care regarding trustee liability in a single case. Yet to be determined, because the facts in this case did not require such an inquiry, is the plight of a trustee who is "carrying on business," or a trustee against whom a Bankruptcy Court has authorized the filing of a suit.

IV. PRE-CODE PERSONAL LIABILITY

A. THIRD PARTY LIABILITY

A scholarly article was written in 1978 by E. Allan Tiller, Esq. entitled *Personal Liability of Trustees and Receivers in Bankruptcy,* 53 AM. BANKR. L.J. 75, 98 (Winter 1978). Mr. Tiller's article provides an excellent overview of the law as it existed about the time the Code was enacted. A brief review of the article follows together with comments regarding selected, pre-code cases.

The article divides personal liability into two distinct categories: (1) liability to third parties unconnected with the bankruptcy proceedings, and (2) liability to the estate and interested parties.

With respect to the first category, it is generally acknowledged that the law developed in the leading case of McNulta v. Lochridge, 141 U.S. 327, 332 (1891). The principle developed in

that case is now known as "the McNulta rule." Essentially, the McNulta rule states that actions against receivers are actions against the receivership and are payable only from receivership funds. It states that a receiver's liability is "official not personal." The McNulta rule has been adapted to Bankruptcy trustees. *See* Zeigler v. Pitney, 139 F.2d 595,596 (2d Cir. 1943). McRanie v. Palmer, 2 F.R.D. 479 (Mass. 1942), the court stated: "[R]eorganization trustees, as receivers, are liable only in their official capacities for torts occurring during their management of the debtor's property. They are not personally liable, as would be ordinary trustees." *Id. at 481. See also* Vass v. Conron Bros. Co., 59 F.2d 969 (2 Cir. 1932) and Wood v. Comins, 303 Mass. 367 (1939).

However, the McNulta rule only limits personal liability of trustees to third parties, it does not eliminate it. A distinction is often drawn between liability for wrongful acts committed outside the trustee's scope of authority and immunity for actions committed under the authority of a Bankruptcy Court. A leading case establishing this principle is Smallwood, *supra*. In Smallwood, the plaintiff, who was imprisoned following a securities fraud conviction, alleged that the trustee conspired with the trustee's attorneys to deprive him of "liberty and property." The Court dismissed the action stating:

> [S]ince (the trustee) was elected, duly appointed and qualified as Trustee in Bankruptcy, . . . he must also be treated as a judicial officer. Since (the trustee) had (no) contact with Plaintiff in any manner other than in (his) official capacity, it necessarily follows that (he) is . . . immune from suit.

Id. at 404.

B. LIABILITY TO THE ESTATE AND ITS CREDITORS

Mr. Tiller further comments at page 89 that, "While the McNulta rule governs liability to third persons, it has no relevance to liability to interested parties." Yet, personal liability to the estate and interested parties is an even more likely scenario for Bankruptcy trustees, who may be fiduciaries for all the interested parties in a case who are each competing for a "piece of the pie." Mr. Tiller also reports at page 91 that Bankruptcy officers have been found personally liable primarily in cases based on violation of their fiduciary duties to collect, preserve, and distribute the estate. Additionally complex, misunderstood and randomly enforced tax and environmental laws have become issues that every trustee faces routinely.

In cases involving interested parties, the standard of care to apply is paramount. Decisions discussing the standard range from mere negligence to willful misconduct. *See* In re Johnson, 518 F.2d 246, 250 (10th Cir. 1975), which stated that "the standard applicable to the surcharge of a bankruptcy trustee is negligence." Some courts still follow the earlier rule as stated in In re Marcus, 2 F. Supp. 524, 525 (W.D. Pa. 1932) that "a receiver is liable to surcharge only when guilty of fraud or supine negligence equivalent to fraud." *See also* Evans v. Williams, 276 F. 650, 655 (6th Cir. 1921) which reasoned ". . . his liability must be based upon his gross and culpable negligence and misconduct. . ." Other courts have virtually ignored the question of whether ordinary or gross negligence exists and have based personal liability on a

willful and deliberate act in violation of the trustee's fiduciary duties. (*See* Sherr v. Winkler, 552 F.2d 1367 (10th Cir. 1977)).

As we know, the issue of personal liability of Bankruptcy trustees was not addressed by the Code when it was enacted. Additionally, the issue has also escaped the attention of Congress in every subsequent amendment to the Code including the 1994 Reform Act. This is inconsistent with the well known, Congressional intent to establish a precise body of Bankruptcy law, to be uniformly applied throughout the country. However, at least one Court has recently indirectly addressed this issue. In re Sundance Corporation, 149 B.R. 641 (Bankr. E.D. Wash. 1993) is a case which, in ruling that a receiver and bankruptcy custodian was entitled to derived judicial immunity under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), raised the specter of the basic constitutional principle of separation of powers! The Court declares at page 659 as follows:

> Judicial immunity was an established essential element of the judicial power of the sovereign when the United States Constitution was adopted, and the concept is inherent in our judicial branch of government. As a fundamental principle upon which our judiciary is founded, personal judicial immunity can not be eliminated by a simple act of Congress as this would constitute an impermissible infringement of the principle of separation of powers.

Query whether a new Code section could be drafted to provide a uniform statute governing derived judicial immunity which would not limit such immunity in an unconstitutional manner.

Furthermore, the United States Supreme Court has not tackled the precise issue of derived judicial immunity since Mosser v. Darrow, 341 U.S. 267 (1951), In Mosser, *supra*, the trustee was held personally liable for willfully and deliberately permitting his agents to profit at the expense of the estate. The Supreme Court offered two suggestions for avoiding personal liability:

1. Seek court approval with notice to creditors and other interested parties;
2. Account at prompt intervals, placing the burden on others to raise objections.

(*See also* In re Kashani, *supra*).

However, Mosser has proved to be an inconclusive case which has been subsequently cited by Courts all over the country in support of many divergent positions on the standard of care governing trustee personal liability. The result is a "crazy quilt" of decisions in the Federal Judicial Circuits following enactment of the Code.

V. PERSONAL LIABILITY FOLLOWING ENACTMENT OF THE CODE

In re Cochise College Park, Inc., citing Mosser the court held that a trustee liable for intentional and negligent violations of duties imposed by law. Typical of contrary decisions is one made several years later. In Matter of Creative Cuisine, Inc., 96 B.R. 144, 147 (Bkrtcy. N.D. Ill. 1989), the Court ruled that a debtor-in-possession, which has "the rights, powers, and duties of a trustee serving in a Chapter case," had no personal liability. It stated that "personal liability will be imposed on trustees ...only

if they deliberately breach their fiduciary duties or act outside their authority."

Similarly in Mullis v. U.S. Bankruptcy Court, Dist. of Nevada, 828 F.2d 1385, 1390 (9th Cir. 1987) *cert. den.* 486 U.S. 1040 (1988), a debtor brought a civil rights action against Bankruptcy judges, court clerks, and a trustee. The Court found that the trustee had "absolute quasi-judicial immunity from damages," reasoning that the trustee derives his immunity from the judge who appointed him. The Court ruled that all actions complained of were "within the ambit of the trustee's official duties." Since judges had immunity, the Court concluded, "so did the trustee they appointed." *Id.* at 1391. In accord is Wickstrom v. Ebert, 585 F. Supp. 924, 934 (E.D. Wis. 1984), which, citing Smallwood, *supra*, states:

> "[J]udicial immunity not only protects judges against suit for acts done within their jurisdiction, but also spreads outward to shield related public servants, including sheriffs, police officers, clerks of court, referees and trustees in bankruptcy, and receivers appointed to conserve assets."

Shortly thereafter, the United States Bankruptcy Appellate Panel of the Ninth Circuit issued an opinion which recognized the doctrine of derived judicial immunity in the case known as In re Jacksen, 105 B.R. 542, 546 (9th Cir. BAP 1989). At page 544 the Court stated:

> "The Courts have recognized that 'judicial immunity not only protects judges against suit from acts done within their jurisdiction, but also spreads outward to shield related public servants, including . . . trustees in bankruptcy . . .' Bennett v. Williams, 87 B.r.

> 122, 123 (S.D. Cal. 1988). See Wickstrom v. Ebert, 585 F. Supp. 924, 934 (E.D. Wis. 1984). That immunity, however, is not unlimited."

The Court then cited other appellate decisions which limited that immunity as follows: (i) "a bankruptcy trustee may be held liable for negligence as well as intentional conduct pertaining to duties placed on him by law." *See* In re Cochise College Park, Inc.: (ii) "[a] trustee has immunity only if his actions are within the scope of authority conferred upon him by statute or the court." *See* In re Tucker Freight Lines, Inc., 62 B.R. 213, 217 (Bankr. W.D. Mich. 1986). *See also* Boullion, supra. The Court in Jacksen, supra, finally concluded at pages 545 and 546:

> ". . . a trustee, who obtains court approval for actions under the supervision of the bankruptcy judge, is entitled to derived immunity. Boullion, supra, 639 F.2d at 214. See also In re XRX, Inc., 77 B.R. 797, 798 (Nev. 1987)."

In re XRX, Inc., further declared that even when a trustee made an erroneous disbursement of funds to pay administrative expenses, he was not subject to personal liability, because he had acted pursuant to court order. Further, the XRX Court stated that "it was entirely inappropriate for [the plaintiff] to initiate this action against [the trustee] personally."

In re Center Teleproductions, Inc., 112 B.R. 567 (Bankr. S.D. N.Y. 1990), provided an exception to decisions granting trustees absolute immunity when acting pursuant to court order. In this case, a tenant of property sold at auction, brought suit to hold the trustee and the auctioneer personally liable for its losses. It was alleged that the trustee was not entitled to judicial

immunity because he had misrepresented the facts to the court in obtaining the order for the auction sale. The Court reviewed many of the cases cited above, and concluded:

> "[A] bankruptcy trustee is immune from suit for personal liability for acts taken as a matter of business judgment in acting in accordance with statutory or other duty or pursuant to court order."

Id. at 578. However, the court added a significant "loophole":

> "Where the trustee negligently fails to discovery his agent's negligence, negligently obtains a court order, or negligently or willfully carries out a court order he knew or should have known he wrongfully procured, however, personal liability will attach."

Yet, the Center Court reasoned that in such cases, the proper remedy is "to appeal, not to collaterally attack the order." Id. at 577.

The United States Bankruptcy Court for the Eastern District of Pennsylvania rendered a memorable decision known as In re Sturm, 121 B.R. 443 (Bankr. E.D. Pa. 1990) when it reluctantly concluded that it would be obliged to impose liability on a trustee charged with mere negligence, because it was bound to follow decisions in the Third Circuit which were over fifty years old! (Although it declined to find the trustee negligent). In re Prindible, 115 F.2d 21 (3rd Cir. 1940) and In re Lambertville Rubber Co., 111 F.2d 45 (3rd Cir. 1940).

The Court also outlined the state of the law in districts other than its own, stating at page 447:

> "Unfortunately, our review of this subject reveals that significant differences exist among the Courts of Appeals and inferior courts, apart from those of our own Third Circuit, regarding the standards for determining when a trustee is immune from personal liability from suit. A few courts have held that a trustee is personally liable 'only for a willful and deliberate violation of his fiduciary duties.' In re Chicago Pacific Corp., 773 F.2d 909, 925 (7th Cir. 1985); United States, etc. v. Sapp, 641 F.2d 182, 185 (4th Cir. 1981); and In re Tucker Freight Lines, Inc., 62 B.R. 213, 217 (Bankr. W.D. Mich. 1986). Cf. In re San Juan Hotel Corp., 847 F.2d 931, 937 (1st Cir. 1988) (trustee held to have engaged in willful and deliberate violation of duties was held personally liable)."
>
> A larger number have held that a trustee may be 'surcharged' or held personally liable for mere negligence. *See* In re Gorski, 766 F.2d 723, 727 (2d Cir. 1985); Red Carpet Corp. of Panama City Beach v. Miller, 708 F.2d 1576, 1578 (11th Cir. 1983); In re Cochise College Park, Inc., 703 F.2d 1339, 1357 (9th Cir. 1983); Ford Motor Credit Co. *supra*; Sherr v. Winkler, 552 F.2d 1367, 1374 (10th cir. 1977); In re B.A. Montgomery & Son, 17 F.2d 404, 406-07 (N.D. Ohio 1927); and In re Consupak, Inc., 87 B.R. 529, 542 (Bkrtcy. N.D. Ill. 1988). *See generally,* E.A. Tiller, Personal Liability of Trustees & Receivers in Bankruptcy, 53 AMER.BANKR.L.J., 75 93-96 (1978) (cited as "Tiller").
>
> Since the Defendants in this case have attributed prominence to this court's orders authorizing the distribution effected which excluded the Plaintiff's claim and closed the case after distribution, we must also consider the applicability of cases holding that '[b]ankruptcy trustees are entitled to broad immunity from suit when acting within the scope of their authority and pursuant to court order,' Bennett v. Williams, 892 F.2d 822, 823 (9th Cir. 1989), and that, when a trustee is

"acting under the authority of the bankruptcy judge, [he] is entitled to derived judicial immunity because he is performing an integral part of the judicial process. Lonneker Farms, Inc. v. Klobucher, 804 F.2d 1096, 1097 (9th Cir. 1986). *See also* Mullis v. U.S. Bankruptcy Court for District of Nevada, 828 F.2d 1385, 1390 (9th Cir. 1987); Yadkin Valley Bank & Trust Col. (sic) v. McGee, 819 F.2d 74, 76 (4th Cir. 1987); Boullion *supra*; United States v. Eyges, 286 F. 683, 684 (D. Mass. 1923); In re Jacksen, 105 B.R. 542, 544-46 (9th Cir. 1989); and Tiller, *supra*. 53 AMER.BANKR.L.J. at 98.

The case law in the Federal Judicial Circuits has been slow to change. Although few circuits are currently principally being guided by cases which are over fifty years old, a recent review of the decisions produced no United States Court of Appeals decisions which significantly changed the basic standards of care in any circuit in the last two years. However, the 4th Circuit ruled on September 16, 1993, at page 752, in a previously decided case known as Yadkin Valley Bank & Trust Co., et al. v. Ling McGee, Trustee, et al., 5 F.3d 750 (4th Cir. 1993) that although the Code imposes specific duties on Bankruptcy trustees, *see, e.g.*, 11. U.S.C. §704 (Supp. II 1978) (amended 1984 and 1986) the Code does not explicitly make trustees liable for breach of those duties. The Court further stated that the source of trustee liability lies in the Supreme Court's decision in Mosser, *supra*. While this case does not squarely alter the standard of care in the 4th Circuit (personal liability only for willful and deliberate violations), which was established in the Sapp, *supra*, case in 1981, it does expand the standard of care in unexpected ways while highlighting

the risky nature of the business of a bankruptcy trustee. The Court states at pages 753 and 754 as follows:

> In fact, the duty to close the estate expeditiously is the trustee's "main duty," 4 Collier on Bankruptcy, [*supra*], §704.01(3) at 704-5 and "overriding responsibility," Estes & Hoyt v. Crake (In re Riverside - Linden Ins. Co.), 925 F.2d 320, 324 (9th Cir. 1991) . . . the duty to close the estate expeditiously will often conflict with other duties, In re Melenyzer, 140 B.R. 143, 155 (Bankr. W.D. Tex. 1992), but this conflict is explicitly recognized in the text of the statute itself, which requires the bankruptcy trustee to balance the need for expeditious conduct against the "best interests of parties in interest," 11 U.S.C. §704(1). . . . So construed the statute itself provides the necessary standard of care.

Another unexpected way the scope of the standard of care may have been expanded is found in In re Chicago Art Glass, Inc., 155 B.R. 180 (Bankr. N.D. Ill. 1993). In this case the Court cited at pages 187 and 188 the Melenyzer, *supra*, and the Cochise College Park, Inc., *supra*, cases stating:

> Although a trustee will not be liable for misjudgments in matters where discretion is allowed, "he or she may be held liable for both negligent and intentional violations of the duties imposed upon him by law." . . . Further, even though the trustee has no obligation to investigate every matter that is brought to his or her attention, the trustee is statutorily required to look into charges of concealment of assets, fraudulent conduct, and any other wrongdoing by the debtor or third parties.

The Court decided in this case that the Bankruptcy trustee's failure to act affirmatively, upon learning of misappropriated estate assets, is negligence and a breach of his or her fiduciary duty to the estate. It remains yet to be seen how much greater the

burden will be, for bankruptcy trustees to investigate (often without pay) and refer to the United States Trustee and the United States Attorney instances of bankruptcy fraud and/or crime, pursuant to the amendments made to 18 U.S.C. §152-156 under the 1994 Reform Act.

Bankruptcy cases involving issues relating to taxes is another virulent area expanding, if not changing, the standard of care in various judicial circuits. While bankruptcy judges tend to follow the decisions reported in this article when dealing with the much lengthier Internal Revenue Code, Treasury Regulations and their predecessors (which have been a major object of attention of Congress and the electorate since the enactment of the Sixteenth Amendment in 1913) United States Appellate Courts have been more likely to rule in favor of the Internal Revenue Service (the "IRS") despite decisions supporting derived judicial immunity for Bankruptcy trustees.

One such example of this is the case of United States of America v. Hemmen, 51 F. 3d 883 (9th Cir. 1995). The Court held that the trustee, who was the recipient of an IRS notice of levy at a time when the estate had assets which were not liquidated, was personally liable under 26 C.F. R. §301.6332(c)(1) for failure to honor the levy. The Court stated further that it was aware of the added burden on bankruptcy trustees, but that a contrary conclusion would impose an additional burden on the IRS' ability to expeditiously collect delinquent taxes, despite the IRS' failure to object to the proposed distribution or to otherwise alert the

trustee to the consequences of same. The Court also concluded (we suppose to avoid overruling earlier contrary decisions) that the action of the trustee was either intentional or negligent and violated the trustee's legal duty to honor the levy.

A similar result was reached earlier that year in United States v. Ruff, 179 B.R. 967 (M.D. Fla. 1995), *Appeal Docketed*, No. 95-2665 (11th Cir.). The Chapter 7 trustee employed a business broker pursuant to order. Following the sale of the business but prior to the entry of an order authorizing the broker's fees, the IRS served the trustee with a notice of levy for the broker's outstanding federal tax liabilities. Since the fees were not awarded at that time, the trustee reported that no funds were due the broker. He subsequently paid the broker after entry of the order. The district court found the trustee personally liable for the entire amount of the broker's fees and came dangerously close to awarding statutory prejudgment interest as well.

If these cases are followed elsewhere, they will be bitter pills to swallow for bankruptcy trustees, who have come to rely on such rulings involving tax questions as the following. In re William J. Walton, Joyce D. Walton, 158 B.R. 943 (Bankr. N.D. Ohio 1993) held that a bankruptcy trustee did not violate his duty of care to bankruptcy estates in his personal or official capacity in transferring to a receiver a tax refund check that was estate property due to a mistaken belief that the check was subject to secured claims of creditors.

Finally, the Bankruptcy Court in the Western District of Michigan issued an opinion on November 7, 1994, which if not reversed, may render moot the entire discussion of different standards of care for different Federal Judicial Circuits! United States of America v. Lasich (In re Kinross Manufacturing Corporation, 174 B.R. 702 (Bkrtcy. W.D. Mich. 1994)), cites Reich, *supra,* and finds that the standard of a trustee's acting "faithfully," as set forth in the trustee's bond, to be equatable with the standard of negligence. One who "negligently" performs an official duty does not "faithfully" perform it. This ruling may effectively circumvent the rule of law established in the Sixth Circuit in 1982 and reaffirmed in 1986 that a bankruptcy trustee is personally liable only for willful and deliberate violations of the law outside the scope of authority granted by statute. What purpose will be served by such apparent protection if bonding companies are required to pay on the standard of mere negligence and then be permitted to successfully sue trustees personally in contract?

Another case in this apparent new line of cases is In re Ferrante, 51 F. 3d 1473 (9th Cir. 1995). In this case the bonding company was held liable not only for estate money converted by a trustee, but also for other damages including commissions and fees paid by third parties to the trustee, the return of an interim award to the trustee which the court vacated, and for reimbursement of accounting and attorney's fees incurred by the successor trustee in investigating the original trustee's misadministration of the

estate. One can only imagine the damage this case can do to the notion of derived judicial immunity for a trustee who makes an honest mistake!

VI. CONCLUSION

The review of the current law made by the Bankruptcy Court in Sturm, *supra,* clearly indicates that little progress has been made since the enactment of the Code to provide a uniform standard of care governing trustee personal liability. This "crazy quilt" of decisions is presented in an illustration of our thirteen Federal Judicial Districts and in a Brief Summary of Post Code Decisions on the Standard of Care Governing Trustee Personal Liability, both of which are appended to this article.

The United States Trustee, the Bankruptcy and Appellate Courts, and even the United States Congress, have almost universally agreed that bankruptcy trustees were underpaid and overworked. However, increased compensation for bankruptcy trustees provided by the 1994 Reform Act was welcome but inadequate relief. Despite legislative efforts to improve the lot of bankruptcy trustees, more cracks have appeared in the trustee's armor of derived judicial immunity since the enactment of the 1994 Reform Act than in the two years prior thereto, as demonstrated by the cases cited above following the review in Strum, *supra*. Moreover, the constitutional mandate of separation of powers may make further relief from Congress on this issue at best difficult to draft, and at worst, unconstitutionally impermissible.

Perhaps answers will be found by courageous trustees who are willing to appeal adverse decisions, whether or not the outcome is financially significant to the estate, its creditors or the trustee. Certainly associations such as the National Association of Bankruptcy Trustees (the "NABT") can be instrumental in supporting such appeals for the greater good of bankruptcy trustees nationally. While some worthy efforts are being made, not enough is being done at this level to have the desired effect. Suits against bankruptcy trustees and their professionals are still an ever-increasing tactic to dissuade aggressive trustees from the enthusiastic performance of their duties. Compounding the problem until recently, has been the fact that trustees could not find professional liability insurance to cover all services required of them by the Code and the regulations, policies and practices promulgated by the United States Trustee. The NABT has been soliciting information from trustees who believe they have been professionally aggrieved without due process for several years. This process should be expanded to inform such national organizations regarding attempts to hold trustees personally liable. Direct contact or contact through national organizations with the National Bankruptcy Review Commission may be part of the solution.

The Ninth Circuit Bankruptcy Appellate panel in Jacksen, *supra*, proclaimed over forty years ago at page 545-546 the primary reason that bankruptcy trustees should demand and receive wide

support from Congress, as well as their own national associations, of mandatory, broad, immunity from personal liability as follows:

> Sound policy also mandates immunizing the trustee. The possibility that we would hold trustees personally liable for judgments rendered against them in their representative capacity would invariably lessen the vigor with which trustees pursue their obligations. Immunity is essential because, as Judge Learned Hand noted, "to submit all officials, the innocent as well as the guilty, to the burden of a trial and to the inevitable danger of its outcome, would dampen the ardor of all but the most resolute, or the most irresponsible, in the unflinching discharge of their duties." Gregoire v. Biddle, 177 F.2d 579, 581 (2d Cir. 1949).

Certainly, the Court's opinion is even more relevant today than it was then.

Mr. GEKAS. We'll start the questioning with the last witness. Well, then you favor the Grassley amendment or the Senate version——

Mr. RAY. Yes.

Mr. GEKAS [continuing]. Of the appeal process, shall we say?

Mr. RAY. Yes, we do.

Mr. GEKAS. You had mentioned in your testimony that rarely does the panel trustee deal directly; that sometimes you have to meet with a staffer from the U.S. Trustee's Office. That's a complaint that we Congressmen hear quite often. With 40 appointments a day, sometimes the staffers deal with the problem directly. Are you saying that no problems are resolvable at the staff level?

Mr. RAY. Oh, no, absolutely not. As á matter of fact, in our district Marcy Tiffany is the U.S. Trustee, and she is very addressable. Any time I need her, I can call her. All I was saying was that usually you aren't dealing with anybody on that level; you're dealing with somebody down below, and if it's just a little administrative thing, I'm not going to call Marcy and object to her on that subject. If it's something major, then certainly I'm going to call her and talk to her about it.

Mr. GEKAS. All right. Mr. Freedman, our information is that that surcharge about which you testified has been dropped. Is that generally——

Mr. FREEDMAN. Yes, sir, I understand that.

Mr. GEKAS [continuing]. Understood?

Mr. FREEDMAN. Yes. But I also understand it's possible it could come back again at some point in the future. So I wanted to make sure that our view was known——

Mr. GEKAS. Like taxes in Congress?

[Laughter.]

Mr. FREEDMAN. Right. Yes, but we're against that surcharge on chapter 13 debtors.

Mr. GEKAS. Yes. And you had—I wrote down a note, and I can't remember why. Oh, on removal of trustees that you were talking about earlier, that there was a rash of that at the beginning, in your early days as a trustee.

Mr. FREEDMAN. Initially, I guess there were some problems when the——

Mr. GEKAS. What kind of problems would you say are generic that resulted in wholesale removal of trustees?

Mr. FREEDMAN. Well, not wholesale removal, but——

Mr. GEKAS. Well, that's the way it sounded to me, that there was a lot of it.

Mr. FREEDMAN. Initially, when the U.S. Trustee Program took effect, there were a number of cases where trustees had stolen money, and those trustees were removed. And you just don't see too much of that going on anymore. It was more at the beginning than it is happening right now.

Mr. GEKAS. How is a typical case of secretion of funds or self-allocation of funds uncovered?

Mr. FREEDMAN. As a private lawyer, I can't really tell you. I try to do the best job I can for my clients, and I'm not familiar with how they would uncover how a trustee is stealing.

When I was a trustee, from 1977 through 1984, there wasn't really anyone, watching over us, except for the judges.

Mr. GEKAS. Mr. Hildebrand, you might want to add——

Mr. HILDEBRAND. Well, as a practitioner, before the U.S. Trustee Program, I was involved in a chapter 11 case, representing the trustee in a complex chapter 11 case. We became aware of the fact that the trustee was, in fact, hiding funds. As counsel to the trustee, we became aware of that. We were stuck in the ethical dilemma of how one deals with this particular problem, since the U.S. Trustee didn't exist. We removed ourselves from the case, because we had an ethical conflict.

The judges were aware of the fact that if an attorney is withdrawing for undisclosed ethical problems, there must be something wrong in the case. The judges had a problem: who do we turn to? It's a clear example as to why the U.S. Trustee had to come in to be an advocate in that particular action. So, in that context, it was a trustee who had multiple cases in that case, and the chapter 11 case was funneling funds from one account to the other and trying to get a fee on every time he moved funds from one estate to the next.

Mr. MORIN. May I add a comment to that?

Mr. GEKAS. Yes, certainly.

Mr. MORIN. I believe that the removal concept that existed in the early eighties, through the eighties, is dramatically different than the way it exists now. I believe in the early eighties it's much as Mr. Michel and his group discussed, as well as Mr. Freedman. Now we are dealing with what we are calling "de facto removals." We're dealing with those situations where, if a trustee doesn't capitulate or does not agree with what the U.S. Trustee wants, they either give them a zero percentage compensation, telling you cannot—that you can disburse money, but you're not going to get any money to run your office, or—and it doesn't happen very often, but it's the threat of it—or they will, in fact, simply stop assigning cases to a trustee.

There is a trustee now in a western State that's noted in my written testimony that that's exactly what's happening to. And I think the problem we're faced with is that there is no mechanism by which this type of removal can be called to anybody's attention except the executive office, and there it's not realistic to expect that they're going to do anything in support of the standing trustee.

Mr. GEKAS. That mechanism hasn't changed much you're saying or——

Mr. MORIN. It hasn't changed at all.

Mr. GEKAS [continuing]. It's a backup mechanism?

Mr. MORIN. There is no mechanism.

Mr. GEKAS. What Mr. Freedman was saying, that there's improvement now, what you endorse as being an improvement in latter-day problems has come about by self-discipline, so to speak; is that correct?

Mr. MORIN. I believe that the trustees and all the counsel that participate—you're getting a real sophisticated bankruptcy bar, and the trustees are included in that, and I think the judges are and the U.S. Trustees are. I believe what's happening is that we're dealing with situations that it's moved beyond this gross mis-

management by an individual case trustee into a situation where if—the code, under section 324, provides that a trustee may be removed for cause as to existing or cases already assigned. What's happening is that if cases are to be assigned to a standing trustee, the U.S. Trustee, either with the threat of removal or actually no longer assigning those cases, he effects a removal without any determination as to how that's to be adjudicated.

Mr. GEKAS. The time of the Chair, self-imposed, has run out for the first round. I will—the Chair will recognize the gentleman from Virginia, if he wishes to question or state something.

Mr. GOODLATTE. Thank you, Mr. Chairman.

Mr. GEKAS. Except he can't question the Chair. [Laughter.]

Mr. GOODLATTE. No, I wouldn't deign to do that. [Laughter.]

In fact, I thank the Chair's forbearance for allowing me to sit on this panel because, as you know, I'm not a member of your subcommittee, although I am a member of the full committee. And I thank you very much for allowing me to do that. This is an issue I'm very interested in.

I also want to welcome all of the panel members, most especially, Larry Morin, who is one of my constituents and a very able chapter 13 trustee from Lynchburg, Virginia. And, Mr. Chairman, I would say that if all of the trustees in the system were as professionally competent as he, we wouldn't even need the U.S. Trustee system at all.

Let me say that I am very concerned about the situation that has evolved over the years. I had the opportunity to practice bankruptcy law for many years prior to my election to Congress, and I practiced both under the system before the U.S. Trustee system came into play and after it did. One of my law partners was previously a chapter 7 and chapter 11 trustee, a very, very fine trustee, who gave up being a trustee after the U.S. Trustee system went into existence because of the bureaucratic redtape, unbelievable amount of paperwork that came in behind that.

Now there's no question that there were abuses. We had an instance in Roanoke of a trustee back in the 1970's embezzling money, and there was definitely a need for firmer oversight of the trustee system than existed back then. However, I'm concerned that the balance has tipped the other way.

In addition, we have in this system an inherent tension, I think, between the trustees appointed by the process, who are private attorneys, who are compensated in part based upon how well they perform their job and recover assets for the creditors and for the court, and the trustee system, which is a government agency funded by the Government. It is an expensive process to have. It costs over $100 million a year. It has over a thousand employees and operates, in my opinion, on a different accountability standard than do the trustees. That creates a natural tension that I think causes a lot of conflict that cannot be resolved unless there is some independent arbiter of those disputes.

And that's why I support the Grassley amendment and why I would hope that the ability of the trustees to seek essentially redress by the court when there is a dispute over fees, or when there is a dispute over whether the trustee, the U.S. Trustee, is wrongly ceasing to provide cases to one of the trustees that has been ap-

pointed—that trustee ought to have an independent means to determine whether or not they have the ability to continue their work, because if they simply stop providing any new cases to a trustee, that trustee is potentially out of business, notwithstanding the fact that they have not been removed from office through any normal process.

So that is my opportunity to get on my soapbox for a minute and lend some support for the effort of these folks, and I would just open it up to ask them if they wanted to expound on that or refute anything that I said.

Mr. HILDEBRAND. If I could just——

Mr. GEKAS. There's unanimity of disgust with what you said. [Laughter.]

Mr. HILDEBRAND. I think that there is a lot of confusion about what this Grassley amendment actually does. I welcome the support that you've given to that amendment, because it does not seek to give the court the power to remove the U.S. Trustee.

Mr. GOODLATTE. No, and I wouldn't suggest that it does.

Mr. HILDEBRAND. But one of the prepared statements today criticizes it for that reason. Neither does it seek to place the bankruptcy court in the position of administering cases, because the amendment merely asks the court to resolve disputes between two litigants.

Mr. GOODLATTE. If I could be allowed a sports analogy, the umpire, not the manager.

Mr. HILDEBRAND. Right.

Mr. GEKAS. Well, we thank the gentleman, and we'll return to the Chair's second round of questioning, short as that will be.

Mr. Hildebrand, it seems that in your testimony you lamented the fact that early on, or even now, that there is no dispute resolution mechanism. Who failed to establish one, in your judgment?

Mr. HILDEBRAND. I think that when disputes became apparent, it was incumbent on the U.S. Trustee Program to figure out how to best resolve those.

The National Association of Chapter 13 Trustees made a recommendation about a possible dispute resolution mechanism that was totally internal to the program, since the EOUST took the view at the very beginning that the courts have no jurisdiction or authority to review anything they do, except perhaps on an appeal under the APA. But they felt that the bankruptcy court was out of the loop.

We made a suggestion consistent with that. We submitted it to them, and I suspect they're still considering it.

Mr. GEKAS. But the advent of the Grassley amendment would make all of that moot, would it not?

Mr. HILDEBRAND. I don't think so. I think that the Grassley amendment would establish the court as the final arbiter of a dispute. If the Executive Office would propose some mechanism for how they internally can get disputes resolved, that might identify contested issues and encourage minimizing disputes.

Mr. GEKAS. Yes, because as in many other things, the court would entertain jurisdiction only after all administrative remedies have been exhausted. We deal with that every single day in different ways. I assume that that would happen. So if we had this

mechanism in place that you're talking about, then that would be the first resort?

Mr. HILDEBRAND. I think you'd also see there wouldn't be very many disputes. I think very few issues would come up that would require a judge to decide what is a "reasonable and necessary expenditure" to administer the bankruptcy cases——

Mr. GEKAS. We also deal with the tendency here in the Congress to do everything in our power to reduce the caseload of our judges, and here we're doing the reverse by perhaps increasing the caseload of the courts.

In this kind of case, would the judges refer to the master mechanism, do you think, so that in the first instance the judges wouldn't have the case in front of them?

Mr. HILDEBRAND. No, a master wouldn't be available to the bankruptcy court system since it is itself an adjunct to the district court, but the bankruptcy court would not—have very few disputes to resolve. I would assume that an exhaustion of administrative remedies would act as a "master" in reducing the number of disputes. What would remain before the court would only be major issues.

For example, should a trustee be able to put a computer system in the trustee's office to allow creditors' and debtors' attorneys the opportunity to read the records of the trustee by phone-in access, which has been a request of most of the credit community across the country. Many trustees have been denied the opportunity to expand their computer systems by the U.S. Trustee Program. If that issue went through the internal dispute resolution process, and the Executive Office decided it was inappropriate to allow a computer system, then a bankruptcy court could decide whether it was appropriate and necessary but the only issue before the court, then, would be the acquisition of the computer system.

Mr. GEKAS. Mr. Morin.

Mr. MORIN. At the present time those that apply for fees and expenses in the bankruptcy process are allowed, under section 330 and related sections, to make their application to the judge, and the bankruptcy judge makes those determinations. That applies to everybody except a chapter 7—excuse me, a chapter 13 or 12 trustee. So, in that sense, the 13 and 12 trustees are out of the loop in that process.

This wouldn't be adding to their caseload. It might be adding new motions that may not previously have been contemplated, but, as Mr. Hildebrand points out, the volume is grossly exaggerated, that it would suddenly create a groundswell of hearings.

The other thing is I think that the committee may want to consider, either at its leisure or by supplemental information, the types of issues that deal with chapter 13 trustee budgets. The most common are employees, the staff, the ability to hire and retain employees; space for rent, or whatever, to run the offices; equipment. These are the types of expenses that are normal and intrinsic in a business operation. These are the types of expenses where the micromanagement has occurred, and if they continue to occur without a remedy available, then we haven't progressed.

Mr. GEKAS. All right, let's take a vote here, as the last item of business, as to yes or no on the Grassley amendment. Mr. Hildebrand?

Mr. HILDEBRAND. Oh, absolutely in favor of the Grassley amendment.

Mr. MORIN. Emphatically in favor of it.

Mr. GEKAS. Mr. Freedman.

Mr. FREEDMAN. In favor of it.

Mr. GEKAS. Mr. Ray.

Mr. RAY. We're certainly in favor of it.

Mr. GEKAS. Did that pass? [Laughter.]

We thank the panel for their presentation.

Mr. HILDEBRAND. Thank you.

Mr. MORIN. Thank you, sir.

Mr. GEKAS. And we thank Mr. Goodlatte for helping us out.

Our final panel consists of the Honorable William Bodoh—or Bodoh; how is that pronounced?

Judge BODOH. Bodoh.

Mr. GEKAS. Bodoh, that's what I thought. He is a U.S. bankruptcy judge in Youngstown, OH, a suburb to New Castle, PA, and is representing the American Bankruptcy Institute.

Jean FitzSimon practices law in Phoenix, AZ, and is chair of the Subcommittee on Bankruptcy Administration and the U.S. Trustees of the American Bar Association.

Prof. Frank Kennedy is a law professor at the University of Michigan School of Law, and he's appearing for the National Bankruptcy Conference.

And Harry W. Greenfield has practiced law in Cleveland, OH, for 26 years and represents the Commercial Law League.

As is our custom already noted, we will begin the testimony in the order in which we presented the panelists, with Mr. Bodoh.

STATEMENT OF HON. WILLIAM T. BODOH, U.S. BANKRUPTCY JUDGE, ON BEHALF OF THE AMERICAN BANKRUPTCY INSTITUTE

Judge BODOH. Good morning, Chairman, members of the subcommittee. I'm William Bodoh, appearing on behalf of the American Bankruptcy Institute. I've served as a judge of the U.S. Bankruptcy Court for the Northern District of Ohio since June 1985, serving in a small community, as the chairman has recognized, just west of the great city of New Castle, PA.

I've served as a member of the Sixth Circuit Judicial Council, representing bankruptcy judges of that circuit. I've served 5 years as a member of the board of governors of the National Conference of Bankruptcy Judges. I am a fellow of the American College of Bankruptcy, and I currently serve as a member of the board of directors of the American Bankruptcy Institute. I am pleased to present the views of the institute to this oversight panel.

The ABI is the Nation's largest multidisciplinary organization devoted to research and education on the insolvency issues in the bankruptcy system. We are both nonprofit and nonpartisan. Our membership consists of persons from many interest groups, both debtors and creditors. Indeed, Mr. Chairman, we pride ourselves in being the umbrella under which all persons and entities with an

interest in the betterment of the insolvency and bankruptcy system find common ground.

The broad diversity of our membership provides the depth and perspective which we believe will assist the subcommittee in its oversight responsibilities, as we take no advocacy position with regard to any interest group. We are observers of the system and the part played in it by the U.S. Trustee and others.

Last fall the ABI published a thorough analysis of the U.S. Trustee system as part of a national symposium series on current bankruptcy issues. This analysis in the form of a series of white papers, prepared by leading advocates for and against the U.S. Trustee system, was presented at the ABI's Southwest Bankruptcy Conference in Santa Fe, NM. As is our policy and custom with ABI research efforts, all viewpoints were represented. The product of this effort, a bound volume entitled, "Administrative Oversight in the Bankruptcy System: Who Should Guard the Hen House?" has been made available to the subcommittee's members and staff.

The mission of the U.S. Trustee Program has been, and remains, to help ensure the integrity of the bankruptcy system, a system that, indeed, in the recent running 12-month period saw over 1 million new cases filed. The program was intended to permit bankruptcy judges to focus on judicial, rather than administrative, matters.

The National Academy of Administrators, in its report on the U.S. Trustee Program last year, noted that the program has struggled since its inception to gain acceptance within the bankruptcy community. Occasionally, there have been calls to abandon the current U.S. Trustee Program and return the administrative role to the courts. Some commentators have pointed to what they call an expectation gap in the development of the program.

In response to criticism, the U.S. Trustee Program has sought to improve its outreach to the constituent parts of the system. Judge Patchan, the current Director, and his staff deserve credit for their sincere efforts to improve the system. The ongoing dialog among the trustees, the Executive Office, and other interested parties is a healthy development which we applaud.

The criticism of the program comes as well from participants in larger chapter 11 cases who complain that the U.S. Trustee's involvement in substantive matters simply adds to the cost of the case without adding any benefit to the estate or creditors, especially in cases where there is already active creditor involvement. And perhaps—perhaps—Congress should clarify the U.S. Trustee's role by creating a distinction between economic and ethical concerns. It certainly is always appropriate, considering what Congress apparently intended in creating the program, for the U.S. Trustee to closely scrutinize professional fees and retention of professionals in cases, to ensure that conflicts of interest are promptly brought to the attention of the court. Certainly more substantive comment on fee applications would be welcome. Despite criticism of the program, many observers credit the presence of the U.S. Trustee as a deterrent to fraud, but I hope that the U.S. Trustee will avoid anointing itself a new super-prosecutor in that process.

There are a number of questions we pose for the committee to consider, and these include: whether the Justice Department is rea-

sonably fulfilling the congressional mandate in administering the U.S. Trustee Program or whether the oversight function has evolved into one of unduly burdensome direction and control. Certainly administration does not equal control of litigants or the courts. My personal interest is in assuring that there is not the unburdensome control.

There are included in my prepared remarks a number of additional questions which we brought to the attention of the committee. We hope that you will have an opportunity to review those and consider them. The U.S. Trustee Subcommittee of the ABI has prepared a draft analysis of several of those issues. Mr. Chairman, I ask that a copy of that analysis be included in my statement.

Mr. GEKAS. Without objection, it will be so included, and the entire statement, as we have stated before, of each of the witnesses will be accepted for the record, without objection.

[The prepared statement of Judge Bodoh follows:]

PREPARED STATEMENT OF HON. WILLIAM T. BODOH, U.S. BANKRUPTCY JUDGE, ON BEHALF OF THE AMERICAN BANKRUPTCY INSTITUTE

Chairman Gekas and members of the Subcommittee, my name is William' T. Bodoh. I have served as a Bankruptcy Judge in the Northern District of Ohio since 1985. Between 1988 and 1993, I served on the Board of Governors of the National Conference of Bankruptcy Judges. I have served on the Board of Directors of the American Bankruptcy Institute since 1995 and on behalf of the over 5,200 members of the ABI, I am pleased to present the ABI's views at this oversight panel on the United States Trustee program.

The ABI is the nation's largest multi-disciplinary organization devoted to research and education on issues related to insolvency. We are non-profit and non-partisan. Our members come from the fields of law, accounting, finance, banking, the judiciary, academia and others. Our members represent both debtors and creditors, individuals and businesses, in bankruptcy cases around the country. The diversity of our membership provides depth and perspective to our views of the many challenges facing the bankruptcy system and dictates that we take no advocacy positions before the Congress.

Thus we are neither advocates or critics of the current role of the United States Trustee. Rather, we serve as interested but dispassionate observers of the form and function of the trustee system, and the role played by the U.S. Trustee within it.

Last fall, the ABI published a thorough analysis of the U.S. Trustee system as part of a national symposium series on current bankruptcy issues. This analysis, in the form of a series of white papers prepared by leading advocates for and against the U.S. Trustee system, was presented at the ABI's Southwest Bankruptcy Conference in Santa Fe, New Mexico. As is customary with ABI research efforts, all viewpoints were represented: a principal legislative architect of the U.S. Trustee Program, a former U.S. Trustee, a standing Chapter 13 Trustee, a sitting bankruptcy judge, practitioners from both systems and the Deputy Director of the U.S. Trustee Program. The product of this effort, a bound volume, entitled "Administrative Oversight in the Bankruptcy System: Who Should Guard the Hen House?", has been made available to the Subcommittee's members and staff.

BACKGROUND

Under the Bankruptcy Reform Act of 1978, Congress established, within the Department of Justice, the U.S. Trustee Pilot Program in 18 judicial districts, to relieve bankruptcy judges of many administrative duties and to separate the functions of trustee appointment and oversight from the judicial functions. In 1986, Congress extended the pilot program nationwide, with the exception of judicial districts in North Carolina and Alabama.

The legislative history on the creation of the U.S. Trustee program suggests that the office was to be decentralized, allowing semi-autonomous offices to exercise independent judgment, largely along the lines of U.S. Attorney offices. The local U.S. Trustees would be supervised by a Washington office, headed by an Assistant Attorney General.

The mission of the U.S. Trustee program has been and remains to help ensure the integrity of the bankruptcy system—a system that is projected to absorb well

over a million new cases this year, an all time record number of filings. The program was also intended to permit bankruptcy judges to focus on judicial rather than administrative matters and to eliminate favoritism arising from the close relationship that was perceived to have existed between trustees and judges under the prior administrative arrangement.

The United States Trustee's role in individual cases is to appoint case trustees, monitor the actions of private panel and standing trustees as well as creditor's committees, to comment on and review fee petitions, and generally help ensure the integrity of the bankruptcy process. Parallel to the U.S. Trustee system, Congress has created (and extended) a separate Bankruptcy Administrator program in North Carolina and Alabama, where the administrator is an employee of the courts. A debate has ensued over which of the two systems is superior. There are also questions over whether these divergent systems run afoul of the uniformity requirement in the bankruptcy clause of the U.S. Constitution.

CRITIQUE OF THE PROGRAM

As was acknowledged by the National Academy of Public Administrators (NAP A) in its report on the U.S. Trustee program last year, the program has struggled since its inception to gain acceptance within the bankruptcy community. It has also suffered at various times over the years from neglect by the Justice Department, political considerations surrounding the choice of Director of the EOUST, lack of focus on the program's central mission, occasional poor appointments of U.S. Trustees and inexperienced field staff, disuniformity of policy pronouncements and budget shortfalls. Occasionally, there have been calls to abandon the current U.S. Trustee program and to return the administrative role to the courts. Recently, trustees in Chapters 7 and 13 have complained that the EOUST has sought to "micromanage" decisions that are more appropriately left to the discretion of the panel trustees themselves.

In response to criticism, the U.S. Trustee program has sought to improve its outreach to the constituent parts of the bankruptcy system. Director Patchan and his staff deserve credit for their sincere efforts to improve the system. We understand, for example, that the EOUST has revised its Chapter 13 trustee guidelines in response to suggestions from the panel trustees. Recently, there has been an acknowledgement by the EOUST that more can and will be done to make public certain dispute resolution procedures that can be used when disputes arise between the Executive Office and individual trustees. The on-going dialogue among trustees, the EOUST and other interested parties is a healthy development which we applaud.

There is also criticism of the program from the participants in larger Chapter 11 cases. The critics here complain that the U.S. Trustee's involvement in substantive matters simply adds to the costs of the case, without adding any benefit to the estate or creditors, especially in cases where there is already active creditor involvement. In such cases, perhaps Congress should clarify the U.S. Trustee's role by creating a distinction between economic and ethical concerns, with the latter always appropriate for U.S. Trustee involvement, while the former only appropriate in smaller Chapter 11's where there is typically little oversight of the debtor. It may always be appropriate for the U.S. Trustee to closely scrutinize professional fees and retention issues, to ensure that there are no conflicts of interest.

Despite criticism of the program, many observers credit the very presence of the U.S. Trustee as a deterrent to fraud by debtors, trustees, creditors and professionals employed in bankruptcy cases. There are numerous illustrations of the U.S. Trustee, in concert with the U.S. Attorney and other federal entities, serving a vital role in identifying and prosecuting bankruptcy fraud. This "watchdog" function is particularly important in smaller cases, where there is limited creditor involvement.

The National Bankruptcy Review Commission, created by Congress as part of the 1994 Code amendments, is considering the effectiveness of the U.S. Trustee system, and possible changes to the laws affecting the work of both the U.S. Trustee and various private panel trustees, who are appointed and monitored by the U.S. Trustee.

CURRENT ISSUES FOR CONSIDERATION

There are a number of questions for the Commission, and this committee to consider, including:[1]

1. Is the Justice Department reasonably fulfilling the congressional mandate in administering the United States Trustee program, or has the oversight function

[1] See, Philip J. Hendel, "The Administration of Bankruptcy Cases Under the U.S. Trustee System: Exploring Options for Improvement," 1995 ABI Annual Spring Meeting.

evolved into one of unduly burdensome direction and control? To what extent can and should the program reconcile national policies and guidelines with the need for local flexibility in practice?

2. Should the Justice Department continue to administer the entire U.S. Trustee program, or have the North Carolina and Alabama Bankruptcy Court Administrator programs met with sufficient success to consider transferring all programs to the U.S. Courts? Does the existing bankruptcy administrator program in these two states create a constitutional problem in that the bankruptcy laws are not "uniform" as required by Article I, Section 8?

3. Assuming the United States Trustee program remains under the jurisdiction of the U.S. Justice Department, should Congress require greater involvement by the private sector (privatization) of certain functions?

4. Should decisions made by the U.S. Trustee in the administration of a case be subject to "de novo" review by the Bankruptcy Court, or should they be subject to reversal in a U.S. District Court only upon a finding of an abuse of discretion? To what extent should the Administrative Procedure Act apply to U.S. Trustee decisions, requiring the exhaustion of administrative remedies before seeking judicial review in the federal courts?

5. Should the attempted removal of a panel or standing trustees by the U.S. Trustee for cause, as to future cases, culminate in a "judicial hearing" to assure that due process concerns are met?

6. How active should the U.S. Trustee be in Chapter 11 cases where an active creditors' committee is already appointed?

7. Should legislation be enacted to limit the liability of panel trustees to intentional wrongful acts constituting gross negligence? Should legislation be enacted to insulate trustees from pre-bankruptcy estate environmental clean up costs and pension plan terminations?

8. Should the tax laws be amended to insulate the estate from liability upon abandonment of assets, specifying that abandonment is a nontaxable event if abandonment occurs during case administration? Should the tax laws be further amended to limit a fiduciary's responsibility to file returns and pay taxes which were due to be filed or paid prior to the fiduciary's appointment?

9. Does a trustee's retaining him/herself or law firm to represent the trustee create an irreconcilable conflict? Further, does 11 U.S.C. 327(d) preclude a bankruptcy court from authorizing a Chapter 11 trustee to retain his or her firm as real estate broker to an estate in which he or she is serving as trustee? [2]

The U.S. Trustee subcommittee of the American Bankruptcy Institute has prepared a draft analysis of several of these issues.[3] I ask that a copy of the analysis be included as part of my statement.

FUNDING ISSUES

The operations of the U.S. Trustee system are funded by user fees, paid by participants in the bankruptcy system. Sources of these funds include debtor filing fees in Chapters 7, 11, 12 and 13, and quarterly fees paid by Chapter 11 debtors during the pendency of these cases. The greatest source of funds are the quarterly fees in Chapter 11 cases. However, as the number of Chapter 11 cases has declined in recent years,[4] there has been a revenue shortfall for the U.S. Trustee program.

On several occasions, Congress has enhanced the program's ability to produce more revenue by raising filing fees and, most recently, permitting the quarterly fee to be extended post-confirmation. This change became effective immediately in late January, when it was included in a stopgap appropriations bill. Some practitioners representing debtors with confirmed plans have been surprised by the retroactive nature of this development, since it has resulted in an additional fee which was not anticipated. The 1997 budget request of the U.S. Trustee program, now included in H.R. 3814, calls for a further increase in the cap on quarterly fees.

CONCLUSION

After nearly 17 years, the U.S. Trustee program is, in many respects, still in its developmental stage, attempting to identify a clear mission and searching for the

---

[2] The U.S. Trustee in New York is appealing to the U.S. Court of Appeals for the Second Circuit an order of the Bankruptcy Court, affirmed by the District Court, that such retention violates the Code. *United States Trustee* v. *Bloom, (In Re Palm Coast)*, No. 96–5009.

[3] The draft was prepared by Daniel L. Freeland, Esq., Komyatte & Freeland; Highland, Indiana.

[4] Chapter 11 filings declined by 20 percent in FY '95, though the total number of filings in all Chapters increased by 5.8 percent.

respect of all the parties to bankruptcy proceedings. We commend the committee for its interest in investigating the U.S. Trustee program and urge you to thoughtfully consider and take the lead in resolving the many questions that surround the U.S. Trustee program. The American Bankruptcy Institute is pleased to assist in this continuing analysis and appreciates the opportunity to appear before you today.

I would be pleased to answer any questions you might have.

Mr. GEKAS. We turn to Ms. FitzSimon.

STATEMENT OF JEAN K. FITZSIMON, ON BEHALF OF THE BUSINESS BANKRUPTCY COMMITTEE, AMERICAN BAR ASSOCIATION

Ms. FITZSIMON. Good morning, Mr. Chairman. Thank you, Mr. Chairman. I am pleased to appear before this subcommittee on behalf of the Business Bankruptcy Committee of the American Bar Association's business section. The ABA supports the continued presence of the U.S. Trustees in the Department of Justice. The ABA, however, does not have a position on the topics we are addressing here today, so the remarks that I will make constitute my own thoughts only.

The concept behind the U.S. Trustee Program is simple: to remove all traces of even the appearance of impropriety in the bankruptcy system by inserting a neutral, independent party to oversee the conduct of the various parties involved in bankruptcy cases. In the short span of the 10 years of the program's national existence, it has received mixed reviews. While criticism of the program is appropriate, much of it arises as a result of their fulfilling the mission that Congress gave them—that of serving as the watchdog of the bankruptcy system. The frank truth is that few will willingly embrace new regulators, especially those who took the greatest advantage of the preregulatory free-for-all.

The U.S. Trustee Program has made substantial improvements in many areas over pre-1978 code practice, particularly in the area of business reorganization. Much of the criticism leveled at the program comes from the private trustees who are appointed by the U.S. Trustees. Clearly, much of the reporting required by the U.S. Trustee system in the past has been burdensome and poorly designed to accomplish what the trustees were trying to oversee. However, much of this has changed, or is changing, and the need for serious reporting requirements is clear. One need only look at the sizable number of defalcations that the trustees have uncovered to know that that continued reporting is required.

More recently, the Department has published standards for the standing trustees in chapter 13 and 12 cases, dealing with such issues as nepotism and the appropriateness of their expenses. Apparently, this constitutes a taking, according to these standing trustees, who also complain that the guidelines constitute micromanagement. Rather astonishingly, the Department has proposed to allow the existing nepotism to continue, at least for the near future, rather than prohibiting the practice immediately except where exigent circumstances can be shown.

We must remember these are fiduciaries who handle substantial sums of money, who must be closely supervised. I do not mean to imply by that that I think there is rampant misbehavior going on in any particular sector of the bankruptcy system, but it is clear that it goes on, and it is clear that it is something that has to be

carefully watched in order to ensure that the money goes to the creditors and back to the debtors, where appropriate, and not into the pockets of individuals.

The only legal area singled out for special treatment in the U.S. Constitution is bankruptcy. Article I, section 8, clause 4, of the Constitution provides that Congress shall establish uniform laws on the subject of bankruptcies throughout the United States. This is a powerful directive. It is critical that this system, which may have the most profound impact on our economy and which involves more people than any other Federal court system, be predictable and fair. The Founding Fathers clearly recognized this.

We cannot ignore the fact that individual and corporate financial distress now has a national impact much greater than ever before, primarily due to the rise in the use of credit cards, the mobility of our populace, and the immense consolidation taking place in the banking industry. With certain limited exceptions, all bankruptcy cases affect each of our pocketbooks. Accordingly, the system is now more national than it ever has been in the past.

While some local variance is appropriate, the treatment accorded by a Federal agency must be uniform, and I think that is most emphatic when we are talking about the treatment of the individual trustees appointed by the U.S. Trustee. Unfortunately, the U.S. Trustee Program suffers because of the intentional, though possibly misguided and certainly misunderstood, emphasis of U.S. Trustee legislation on local variance. While many offices operate well, several U.S. Trustees have taken positions and instituted programs that are contrary to sound bankruptcy administration. The Justice Department consistently has failed to recognize the need for strong and clear national policies for what is still a very young program, and, instead, have treated the U.S. Trustees as the functional equivalent of U.S. Attorneys.

While the system was designed, modeled, on the U.S. Attorneys system, that was a structural model; it was never intended to create a comparable litigation scheme. Bankruptcy cases are not like regular litigation, and to set up the same system would be nonsensical.

There are many parties involved in a bankruptcy case. There are many issues involved in a bankruptcy case. And the net result is that we need a neutral party to take advantage of the oversight that must be involved in such a system.

I see that my time is up.

[The prepared statement of Ms. FitzSimon follows:]

PREPARED STATEMENT OF JEAN K. FITZSIMON, ON BEHALF OF THE BUSINESS BANKRUPTCY COMMITTEE, AMERICAN BAR ASSOCIATION

Good morning. I am pleased to appear before the distinguished members of this subcommittee on behalf of the Business Bankruptcy Committee of the American Bar Association's Business Section. The ABA supports the continued presence of the U.S. Trustees in the Department of Justice. The ABA, however, does not have a position on the topics we are addressing here today, so the following remarks constitute my own thoughts only.

My name is Jean FitzSimon and I am a member of the firm of Johnston Maynard Grant and Parker in Phoenix, Arizona, where I practice primarily in the area of debtor/creditor relations. I chair the ABA Subcommittee on Bankruptcy Administration and United States Trustees. I served as one of two bankruptcy experts on the panel that oversaw the National Academy of Public Administration's ("NAPA") study of the U.S. Trustee System. I also was privileged to serve on the working

group on the U.S. Trustee Program of the National Bankruptcy Conference's Ten Year Bankruptcy Code Review Project. From 1976 to 1987, I was employed by the U.S. Department of Justice, serving from 1982 to 1983 as Acting U.S. Trustee for the Northern District of Illinois in the pilot U.S. Trustee Program. Subsequently I was asked to return to Washington to assist in the drafting and passage of legislation to overcome the constitutional infirmities of the Bankruptcy Court system addressed in the Supreme Court's decision in the *Marathon* case. I was one of the principal authors of the legislation to expand, and make permanent, the U.S. Trustee Program. Ten years ago, I was present in the offices of this Subcommittee when that legislation passed this House. It is a pleasure to be here again.

The concept behind the U.S. Trustee system is simple: to remove all traces of even the appearance of impropriety in the bankruptcy system by inserting a neutral, independent party to oversee the conduct of debtors, creditors, trustees, committees and all other parties in interest under the bankruptcy laws of the United States. In the short span of ten years of the program's national existence, it has received mixed reviews. While some criticism of the program is appropriate, much of it arises as a result of the U.S. Trustees fulfilling the mission Congress gave them, that of serving as the "watchdog" of the bankruptcy system. The frank truth is that few will willingly embrace new regulators, especially those who took greatest advantage of the pre-regulatory free for all.

The U.S. Trustee program has made substantial improvements in many areas over pre-1978 Bankruptcy Code practice. The business reorganization process has, according to all reports, improved substantially as a result of their involvement, with cases moving much more swiftly to successful confirmation. Their involvement in smaller Chapter 11 cases has increased, providing a much more open process than existed previously.

Most of the criticism leveled at the Program comes from the private trustees appointed by the U.S. Trustees. Clearly, much of the reporting required by the U.S. Trustees in the past has been burdensome and poorly designed. However, most of this has changed or is changing and the need for serious reporting requirements is evidenced by the sizeable number if defalcations the U.S. Trustees have uncovered. Most recently, the Justice Department has published standards for standing trustees in Chapter 12 and Chapter 13 cases dealing with such issues as nepotism and the appropriateness of their expenses. Apparently, however, this constitutes a "taking" in the minds of these standing trustees, who also complain that the guidelines constitute micro management. Rather surprisingly, the Department has proposed to allow the existing nepotism to continue among standing trustees in the near term rather than prohibiting this practice immediately, except where exigent circumstances can be shown. These are fiduciaries who handle substantial sums of money who *must* be closely supervised.

The only legal area singled out for special treatment in the United States Constitution is bankruptcy. Art I, § 8, Clause 4 of the Constitution provides that Congress shall establish "Uniform Laws on the subject of Bankruptcies throughout the United States." This is a *powerful* directive.

It is critical that the bankruptcy system, which may have the most profound impact on our economy, and which involves more people than any other federal court system, be predictable and fair. The founding fathers clearly recognized this. We cannot ignore the fact that individual and corporate financial distress now has a national impact much greater than its local impact due to the rise in credit card use, the mobility of our populace and the consolidation taking place in the banking industry, among other things. With certain limited exceptions, *all* bankruptcy cases impact all of our pocketbooks. Accordingly, the bankruptcy system is more truly national now than ever.

While some local variance is appropriate, the treatment accorded by a federal agency *must* be uniform. Unfortunately, the U.S. Trustee program suffers because of the intentional, though possibly misguided and probably misunderstood, emphasis of the legislation on local variance. While many, if not most, of the U.S. Trustee offices operate well, several U.S. Trustees have taken positions and instituted programs that are contrary to sound bankruptcy administration. The Department of Justice consistently has failed to recognize the need for strong and clear national policies for this fledgling program, opting instead to treat the U.S. Trustees as the functional equivalent of the U.S. Attorneys. While the U.S. Attorneys served as the model for the U.S. Trustee system, it was a structural model, designed solely to ensure a strong, exceptionally qualified career staff, *not* to design a comparable litigation scheme. Bankruptcy cases are so fundamentally different from other litigation that such a set up is nonsensical.

Bankruptcy cases involve many parties, many unrelated issues and often involve approval of matters as to which the active parties have no disagreement. As a re-

sult, the existence of a neutral party who seeks to make sure that all matters are conducted in accordance with the law is important, since there is no single other party who will raise concerns to the court on all of the various issues raised in a bankruptcy case. Moreover, often there are insufficient funds available to motivate any one party to oversee the debtor or the trustees and the U.S. Trustee is the only person who can ensure the faithful performance of fiduciary duties.

The legislation creating the new Bankruptcy Code initially provided that the program was to be headed by an Assistant Attorney General. Relegating the Program to an Executive office has left the U.S. Trustees largely unsupervised. The result is that local variance is not based on local considerations but, in many instances, is based solely on the predilections of the individual U.S. Trustee. For example, while in some regions the U.S. Trustees support as well as supervise individual trustees, in others, the individual trustees are treated as all-but-convicted criminals who receive little training and even less support. The current Director of the Executive office is powerless to prevent this, since appointed U.S. Trustees "trump" him in pecking order. The NAPA study, recognizing this problem, urged the Department of Justice to elevate the Director to Assistant Attorney General status.

Since the Congress is charged with ensuring uniformity in the bankruptcy laws, its focus now should be on seeing that the Department of Justice is establishing that predictable and fair system by overseeing the U.S. Trustees. This young program needs strong direction. With that, and time, it will accomplish all of its goals.

I would be happy to answer any questions that you may have.

Mr. GEKAS. We thank the lady, and we proceed to Professor Kennedy.

STATEMENT OF FRANK KENNEDY, PROFESSOR, UNIVERSITY OF MICHIGAN SCHOOL OF LAW, ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

Mr. KENNEDY. Thank you, sir. I appreciate the opportunity to appear here on behalf of the National Bankruptcy Conference, of which I have been a member since 1948.

The National Bankruptcy Conference has devoted its efforts, and its concerns to the improvement of the position of the bankruptcy court to assure that it will function with effectiveness and respect, and I have devoted a good deal of my professional life to an effort to improve the public perception and reception of the bankruptcy court. I was the Executive Director of the Commission on Bankruptcy Laws in the 1970's.

The 1978 report of the Commission recommended two fundamental concerns: that the bankruptcy court should have an expansion of its jurisdiction, freed of many of the technicalities of bankruptcy jurisdiction, and that the bankruptcy court should be kept out of administration, so that there is a separation of administration and judicial functions. There was not ever any resistance to the idea of separating administration from judicial dispute decision, but over the years there is a constant pressure to put the court into administration. Over the years, the National Bankruptcy Conference has stood steadfast in support of maintaining this separation of the court from administration. We have felt, and still feel, and will continue to feel, I think, that to the extent the bankruptcy court gets involved in administration, there is an unfortunate bias, an unfortunate loss of respect for the integrity, and the impartiality of the bankruptcy court.

So when the Bankruptcy Conference, and those who speak as I'm speaking today, resist these proposals of the kind that are under consideration, we are thinking of the public perception of the power and the dignity of the bankruptcy court. Speaking for the National Bankruptcy Conference, I am stating the view that I think is

shared by members of the conference that the kind of legislation that is under consideration here constitutes incremental erosion of the independence and the separation of the bankruptcy court from processes of administration. That is the point I want to make. The papers I have submitted to you emphasize the point that we are afraid that the legislation represents incremental erosion of the independence of the court in carrying out its dispute-deciding function. It is imperative that the bankruptcy court's independence should be respected, perceived, and preserved.

Thank you very much.

[The prepared statement of Mr. Kennedy follows:]

PREPARED STATEMENT OF FRANK KENNEDY, PROFESSOR, UNIVERSITY OF MICHIGAN SCHOOL OF LAW, ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

One matter to come before the Subcommittee on July 24 is a proposal to amend section 524 of the Title 11 of the United States Code to give the court exclusive authority to remove as to future cases a trustee under section 586(b) of title 28. This proposal seems to be ill advised. Section 586(b) of title 28 authorizes the appointment of only standing trustees in Chapter 12 and 13 cases. These standing trustees are appointed by the United Stats trustee and are subject to supervision by the United States trustee. Section 324(a) appropriately recognizes that while a court may remove a trustee, a United States trustee may not be removed by a court. Congress has recognized that the selection and supervision of United States trustees ought to be insulated from court control in order to assure the appearance as well as the reality of independence of administration from court involvement. The separation of administration from dispute-deciding functions in bankruptcy was strongly recommended by the Commission on Bankruptcy Laws and has been consistently supported by the National Bankruptcy Conference. The appearance and reality of the separation of administration from judicial functions should not be eroded by allowing judges to exercise control over the selection and retention in office of United States trustees and the standing trustees that are appointed and supervised by United States trustees.

35-307 0 - 96 - 5

Norton Bankruptcy Law Adviser

Monthly Analysis of important issues and recent developments in bankruptcy law

Editor in Chief: William L. Norton, Jr., Former U. S. Bankruptcy Judge (1971-1985) Attorney at Law, Atlanta, Georgia

May, 1995 | Issue No. 5

IN THIS ISSUE...

1. LET THE UST BE

By Frank R. Kennedy
Professor Emeritus
University of Michigan Law School
Ann Arbor, MI

Two significant reforms effected by the Bankruptcy Reform Act of 1978 were (1) the enlargement of the jurisdiction of the bankruptcy court and (2) the separation of administrative from judicial functions in the administration of the bankruptcy laws. The Supreme Court's ill considered decision in **Northern Pipeline Constr. Co. v Marathon Pipe Line Co.**, 458 US 50, 102 S Ct 2858, 73 L Ed 2d 598 (1982), impaired to some extent the realization of the benefits of the jurisdictional reform provided by the Bankruptcy Reform Act of 1978, but the bifurcation of jurisdiction of core and noncore bankruptcy proceedings has proved to be a decided improvement over the dichotomy between summary and plenary jurisdiction under the Bankruptcy Act.

The separation of judicial from administrative functions was regarded by the Commission on Bankruptcy Laws as an imperative feature of the reforms it recommended in its Report. *Report of the Commission on the Bankruptcy Laws of the United States Part I.* H.R. Doc. No. 138, Part I. 93d Cong., 1st Sess. 5-8 (1973). The Commission emphasized the importance of providing litigants in proceedings before the court with assurance that the bankruptcy judges would be independent and impartial, not influenced by involvement in the selection of trustees, the conduct of meetings, and the day-to-day administration of liquidation and reorganization cases. The Commission set forth its rationale for the separation of judicial and administrative functions in the following paragraphs in the first chapter of its Report:

> When litigation does arise, there are substantial reasons for not entrusting its determination to bankruptcy judges involved in the prior administration of those litigated estates. It is necessary and important that the adversaries have confidence that their controversy will be determined by evidence adduced by them and presented to the trier of the law and the facts. The Commission is convinced that referees' participation in administrative aspects of bankruptcy proceedings tends to

Norton Bankruptcy Law Adviser (USPS XXX-XXX) is published monthly by Clark Boardman Callaghan, 50 Broad St E., Rochester, NY 14694 Subscription price is $265.00 per year Application to mail at second-class postage rates is pending at Deerfield, IL Postmaster Send address changes to Norton Bankruptcy Law Adviser, Clark Boardman Callaghan, 155 Pfingsten Rd., Deerfield, Ill. 60015

Published by
CLARK BOARDMAN CALLAGHAN
50 Broad St. East, Rochester, NY 14694

51

impair the litigants' confidence in the impartiality of the tribunal's decision. In particular, adversaries of the trustee in bankruptcy tend to doubt that the referee who appointed the trustee can insulate himself from at least a suspicion of partiality when he may have previously been involved in any or all of the following actions regarding the same estate: determining that the debtor had committed an act of bankruptcy; the appointment or approval of the election of the trustee; the scrutiny of the petition, schedules, statement of affairs, and other papers filed in the case; the conduct of the first meeting of creditors and other meetings at which examinations of the debtor and other witnesses took place; and conferences with the trustee regarding collection of the assets of the estate and litigation on its behalf.

These considerations have led the Commission to recommend the severance of administrative from judicial functions within the bankruptcy system. Under the proposed Act, administrative responsibilities would be carried out by an agency established by Congress for the purpose. Judicial functions would be performed by bankruptcy judges appointed to bankruptcy courts also established by the Act. It is the view of the Commission that this division is no less necessary than it is between the Internal Revenue Service and the Tax Court.

Id. at 506.

The scheme contemplated by the Commission included as a counterpart to the independent bankruptcy court the United States Bankruptcy Administration, empowered to handle almost all matters in proceedings under the Act not involving litigation. *Id.* at 7-8. The Administration was to be an establishment in the executive branch of the federal government. Citing a critical study of federal judicial administration by Professor Peter Fish, the Commission expressed strong objections to subjecting the Bankruptcy Administration to supervision by the judiciary. *Id.* at 117, 126 (*citing* Peter Fish, *Toward a Judicial Administrator of Limited Powers: Bankruptcy Crisis and the Administrative Office of the United States Courts*, 44 Ref. J. 123 (1970)). Professor Fish had pointed out that the Attorney General's Committee on Bankruptcy Administration in 1940 had reported that the bankruptcy system had suffered from a long list of administrative shortcomings, due in large part to its decentralization and lack of coordination.

The desirability of separating the exercise of judicial functions from the conduct of administration was accepted without controversy by Congress in its consideration of the reforms recommended by the Commission on Bankruptcy Laws. Implementation of the Commission's recommendations for an administrative structure, however, encountered differences of opinion and delay. The Commission's recommendation for the establishment of the United States Bankruptcy Administration as an independent agency was rejected, but establishment of the Office of the United States Trustee as an agency within the Department of Justice was authorized as a pilot project for a five-year experiment in supervised administration in 18 federal judicial districts scattered throughout the United States. Pub.L. No. 95-598, 92 Stat. 2549, 2651-57, 2662-64 (1978); 11 U.S.C. §§ 15101-151326; 28 U.S.C. §§ 581-589.

The operation of the U.S. Trustee system in the 18 districts was the subject of a study and evaluation by Abt Associates Inc. of Cambridge, Massachusetts, authorized by the Department of Justice and completed in May 1983. The timing of the study coincided with a dramatic surge in the bankruptcy caseload. The conclusion of the Abt consultative group was that "the U.S. trustee system has achieved its goals." Nancy L. Ames, Lindsey D. Stellwagen, & Ralph T. Jones, *An Evaluation of the U.S. Trustee Pilot Program for Bankruptcy Administration: Findings and Recommendations* 4 (1983) (hereinafter cited as Abt Associates Report). The conclusions and supporting data in the Abt Associates Report were surely influential in the consideration by Congress in 1985 and 1986 of the question whether the U.S. Trustee program should be continued. The program was made permanent and nationwide in extent, except for the states of North Carolina and Alabama, by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986. Pub.L. No. 99-954, 100 Stat. 3119 (1986); 28 U.S.C. §§ 581-589a (1988). The United States trustee system was extended nationwide in accordance with time tables set out in the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986. The legislation authorized estate administrators appointed under regulations of the Judicial Conference of the United States to serve in lieu of United States trustees. Amendatory legislation enacted in 1990 and 1993 extended the operation of the bankruptcy administrator program in judicial districts in North Carolina and Alabama. Pub.L. No. 101-650, 104 Stat. 5115-5116 (1990); Pub.L. No. 103-65, 107 Stat. 311 (1993). Of particular relevance to the discussion in this paper are the following observations in the Abt Associates Report:

Assuming that the U.S. trustee program were

adopted in some form, a corollary issue is where it should be housed. We believe it should remain where it is now, in the Department of Justice. We ruled out the possibility of housing it in the AO, because—although this would likely ensure judicial support and coordination with the courts—under such an arrangement it would be nearly impossible to guarantee the true separation of judicial and administrative functions. Moreover, the AO is not viewed as a policy-making body, nor has it traditionally acted as such. The executive office for a nationwide bankruptcy administration program must be able to set national policies and procedures, participate in precedent-setting cases, and provide legal advice and assistance to the U.S. trustees. Under its current structure, the AO could not fulfill these expectations.

We would also oppose moving the program to another executive agency, such as the Internal Revenue Service, Small Business Administration, or Department of Commerce. While this approach offers the necessary independence and the potential for a supportive environment, drawbacks include: 1) the threat to the program's long-term stability if future agency heads are not supportive, and 2) potential conflicts of interest with the agency's role as a party in interest.

A third option, creating a new independent, or quasi-independent agency to house the program, also has several disadvantages. It would create an added layer of bureaucracy; it would probably be more costly than a program attached to some larger agency; and it would be more subject to elimination when the federal government undergoes cutbacks or reorganization.

We strongly believe that keeping the program in DOJ is preferable to any of the other options considered, for several reasons. First, to do so would enhance the program's continuity and reap the most benefit from its achievements. Moving the program could disrupt management, overall policy direction, staff, and budgetary planning, and would not take advantage of what has been learned thus far. Second, potential problems of conflict of interest between DOJ as an advocate for the U.S. Government and the U.S. trustee as an impartial case administrator have not materialized. Third, the U.S. trustee program has demonstrated its effectiveness in this location. Finally, the initial reasons for placing the program in DOJ, as cited by the drafters of this legislation, still apply. These reasons are:

* DOJ was staffed with lawyers who could readily understand both the Code and the U.S. trustee mandate;

* DOJ could use its authority to promote coordination between the U.S. trustees and U.S. attorneys;

* DOJ had the prestige to attract high quality U.S. trustees with the know-how to handle difficult matters, both in and out of court; and

* DOJ already employed a similar organizational model, i.e., a U.S. attorney's office in each district and an Executive Office for U.S. Attorneys within the agency. Abt Associates Report at 10-11.

The dramatic increases in bankruptcy filings between 1986 and 1992 raised concerns about the integrity of the bankruptcy system and its ability to handle the increased workload. These concerns led Congressman Jack Brooks as the Chairman of the Subcommittee on Economic and Commercial Law of the Judiciary Committee of the House to address a request to the General Accounting Office for an analysis of "the extent of trustee fraud, the adequacy of Department of Justice bankruptcy trustee oversight, and the potential forconflict of interest in the U.S. Trustee (UST) program." The response to that request filed by Harold A. Valentine, Associate Director of Administration of Justice Issues of the General Accounting Office, dated January 27, 1993, bears particularly on one criticism that has been made of the placement of the Office of the U.S. Trustee in the Department of Justice and warrants summarization and quotation here.

The GAO Report makes appropriate reference to the legislative history that provides a rationale for taking the administrative function from bankruptcy judges and placing it in the executive branch. The Report acknowledges that in the formulation process some thought that placing the case administration function in Justice created a potential conflict of interest in cases in which the U.S. government was a creditor. *General Accounting Office, Report to the Chairman, Subcommittee on Economic and Commercial Law, Committee on the Judiciary, House of Representatives, Bankruptcy Trustees: Oversight Improved, But Extent of Trustee Fraud Is Unknown*, 19 (January 27, 1993). The Report deals with these concerns in three paragraphs as follows:

> There were concerns that this arrangement could create an appearance that the government creditor could be given an advantage over other creditors; Congress rejected these concerns in both the 1978 and 1986 legislation. The legislative his-

tory of the act recognizes that the potential for a conflict of interest exists in both the executive and judicial branches. While the UST program may be sited within the Justice Department, it does not represent the government as a creditor and may, in fact, be in an adversarial position to the Justice attorneys representing the government. At other times the UST program may support the position of a governmental creditor—the position is predicated on the type of action and benefit to the estate rather than the fact that the UST program and the U.S. Attorney are within the Justice Department. Ultimately, it is the court that has the role of arbiter and must approve any actions to be taken. Congress decided that Justice was the best placement for the program given the functions, powers, and duties of the UST program.

> Independent studies done in 1983 and 1985 by Abt Associates were unable to identify any examples in which a conflict of interest between the federal government as a creditor and the case administrator actually occurred. In our September 28, 1982 report we also asked UST staff and bankruptcy judges in the districts visited to identify cases in which UST staff acted to promote the claims of a government agency over other creditors' claims; no one could.
>
> Officials of the AO cited two cases since 1989 in which they thought conflict of interest might possibly have been an issue. However, these two cases, even if substantiated, would represent a negligible proportion of 3,700,000 casesthe program has supervised since the UST program's nationwide expansion in 1987. These circumstances suggest that no significant conflict-of-interest problem actually exists.

Id.

The remainder of the 25-page GAO Report, which is generally positive in its appraisal of the performance of the UST program, provides no basis for any argument that it would be advantageous to transfer the responsibilities and authority of the Department of Justice with respect to the UST program to the Judiciary or the Administrative Office of United States Courts.

Unfortunately, the Committee on Long Range Planning of the Judicial Conference of the United States has made a recommendation for such a transfer:

> Transfer of oversight authority for bankruptcy estate administration was among the measures recommended nearly five years ago by the Federal Courts Study Committee. Placing the U.S. trustee system under judicial branch control would eliminate separation of powers issues and avoid potential conflicts of interest in cases where the federal government, represented by the Justice Department, is a creditor. It would also be considerably less expensive to operate, and would minimize duplication of function and case management conflicts between the U.S. trustees and the bankruptcy courts. At the very least, the parallel bankruptcy administrator program in the judicial branch should be permitted to continue in those districts that currently operate outside the U.S. trustee system or may in the future elect to do so.

Proposed Long Range Plan for the Federal Courts of the Committee on Long Range Planning of the Judicial Conference of the United States at 80 (March 1995).

It is hoped that the Judicial Conference will not follow the recommendation of its committee on Long Range Planning. Its adoption would be a step backward in the effort to divorce the bankruptcy judge from administrative duties and contacts that create at least the appearance of partiality, if not partiality in fact. The only authority for the Proposal of the Long Range Planning Committee is its own subcommittee and an earlier recommendation of the judiciary found in the Federal Courts Study Committee Report. *See Report of the Federal Courts Study Committee* 77-78 (1990) and the *Final Report and Recommendations of the Long-Range Planning Subcommittee of the Committee on the Administration of the Bankruptcy System of the Judicial Conference of the United States* 18-19 (June 1, 1993).

The National Bankruptcy Conference has consistently opposed any vesting of supervisory authority in the Judiciary or the Administrative Office of the United States Courts over the United States Trustee system. Thus, onDecember 14, 1977, during the consideration of H.R. 8200, which was the principal bill that became the Bankruptcy Reform Act of 1978, four spokesmen for the Conference addressed the question of the placement of the United States Trustee. A ten-page memorandum approved the placement by H.R. 8200 of the U.S. Trustee in the Department of Justice. The memorandum pointed out that the NBC had disapproved suggestions that the bankruptcy administrative agency be part of the Administrative Office of the U.S. Courts. "What seems clear," the memorandum declared, "if the separation of [administrative] functions [from judicial functions] is to be achieved, is that the placement should be as far as is possible from the bankruptcy court."

Mr. GEKAS. We thank you, Professor Kennedy.
Mr. Greenfield.

STATEMENT OF HARRY W. GREENFIELD, ON BEHALF OF THE COMMERCIAL LAW LEAGUE OF AMERICA

Mr. GREENFIELD. Thank you. I'm Harry Greenfield. I'm with the firm of Buckley, King & Bluso, and I'm here representing the Commercial Law League of America. I am the current incoming chair of the bankruptcy and insolvency section of the Commercial Law League of America and a past member of the board of governors of that organization.

The Commercial Law League is an organization which is the Nation's oldest organization of attorneys and other experts in credit and finance. We have lay members who are involved in commercial collection procedures, attorneys involved in commercial collection, bankruptcy, in all aspects of commercial life in the United States.

We have submitted a paper which summarizes—which is our testimony. And, in summary, we want to point out that, as has been testified before, the U.S. Trustee Program was designed by Congress to permit bankruptcy judges to focus on judicial, rather than administrative, matters and to limit favoritism arising from as close relationship that was perceived to exist between trustees, bankruptcy professionals, and judges.

While the program has relieved judges from administrative functions, the program has merely replaced the bankruptcy ring, the alleged bankruptcy ring, with a slightly broader group of bankruptcy professionals. The program since its inception has been politicized, and this has created problems in its long-term continuity.

A lot of the criticism comes from the fact that the U.S. Trustee Program has been put into effect to root out fraud and to try to increase the professionalism of the organization, the bankruptcy professionals, trustees, and any organization whose job it is to tell you what a bad job you're doing cannot be received with open arms by people who practice in that area. And a lot of the criticism, we believe, is as a result of people being required to do things that they did not think was necessary. Trustees who are honest are offended by the fact that they have to now do reporting, which would indicate that they were not being honest in the first place. And I think a lot of this is to make sure that the system is appropriate. We believe that the trustee system is doing a good job in the regard of reviewing the trustee activities.

The current overall structure of the U.S. Trustee is also appropriate. We believe that the program as part of the Justice Department is where it belongs. We believe that a separation from the Judicial branch is appropriate. Many of the problems with the program arise as a result of staff attorneys strictly applying policy, whether it makes good sense or not. On many occasions, the local staff attorneys take positions which have been overruled by local courts and will be detrimental to the progress of the case, but they push on due to policy requirements that are in their local office.

Because of certain procedural rules, the U.S. Trustee second-guesses business decisions of panel trustees and other bankruptcy professionals. The Commercial Law League of America believes that the U.S. Trustee Program would be—with some modification,

the U.S. Trustee Program will be as effective as was envisioned by Congress in 1978.

As indicated, you have our written testimony, and I'm going to divert from it slightly, in that on the testimony that I've heard today—there's many things that the U.S. Trustee does well, and I don't want it to be perceived that we think that all that they do is inappropriate. We believe that they oversee the actions of the panel trustees. We believe they do a good job with that.

Someone has to review fee applications. I know, as a bankruptcy professional, I don't like to object in my fellow professionals' fees. They do the job that is required: to review fee applications and to make comments, where appropriate. They review and investigate for fraud, which, as pointed out earlier, they're the only people within the bankruptcy structure that can do this.

They supervise chapter 11 cases where there's no creditors' committee, and we believe that that is a strong function that they fulfill. There needs to be somebody who can appoint chapter 11 trustees and examiners, and there's need of a party to push and speed up the administration of chapter 7 matters. We believe all those areas they're performing admirably.

However, there are areas where, with any group, there can be improvement. They impose, the U.S. Trustee system imposes, their judgment in place of other professionals' judgment, and they make decisions without administrative or court review. And, therefore, we support the Grassley amendment.

We don't believe that they also don't always protect the system in the way that they should protect it, and don't take positions where appropriate.

I see by the red light my time is up. Thank you for your consideration.

[The prepared statement of Mr. Greenfield follows:]

Prepared Statement of Harry W. Greenfield, on Behalf of the Commercial Law League of America

On behalf of the Commercial Law League of America, the nation's oldest organization of attorneys and other experts in credit and finance actively engaged in the field of commercial law, bankruptcy and reorganization, the League is pleased to submit the enclosed position statement on the U.S. Trustee Program for the House Judiciary Committee's Commercial and Administrative Law Subcommittee July 24th hearing. The Commercial Law League will be represented by Harry W. Greenfield, of Buckley, King & Bluso, 1400 Bank One Center, Cleveland, Ohio (216) 363-1400.

In developing its position, the League was pleased to be involved in an extensive and probing paper on the U.S. Trustees Program authored by Philip Hendel. The Commercial Law League was invited by Mr. Hendel to join and endorse the specific issues presented in that paper and officially does so. However, while Mr. Hendel concludes the Program may be working "quite well" in some districts, the League believes differences in opinion exists about its overall effectiveness.

The position addresses 12 specific issues relating to the U.S. Trustee Program. In addition to merely identifying these issues, the position paper includes recommendations on how to resolve the issues and to improve the Program in order for it to succeed in its mission.

The U.S. Trustee System: Important Issues and Potential Solutions for Consideration by the Bankruptcy Review Commission

(By: Philip J. Hendel, Hendel, Collins & Newton, P.C., Springfield, MA)

BACKGROUND

Under the Bankruptcy Reform Act of 1978, Congress established the U.S. Trustee Pilot Program in 18 judicial districts. According to the initial House report on the 1978 Act, the U.S. Trustee Program was to provide decentralized, semi-autonomous officials who would administer the bankruptcy laws. The program was also intended to permit bankruptcy judges to focus on judicial, rather than administrative matters and to eliminate favoritism arising from the close relationship that was perceived to exist between Trustees and Judges.

Its initial success prompted Congress to replace the pilot program with a permanent national one which was phased in over a two-year period for all states except North Carolina and Alabama. North Carolina and Alabama continue to operate with Bankruptcy Court Administrators under the aegis of the U.S. Courts.

The Bankruptcy Reform Act of 1978 envisioned the appointment of an Assistant Attorney General, nominated by the President and confirmed by the Senate, to assist the Attorney General in matters related to United States Trustees. The Attorney General would have only a small staff and would offer general administrative assistance and support services in individual cases to the U.S. Trustees in each judicial district where the bulk of the work would occur. The Attorney General did appoint a director of EOUST, but has never upgraded the position to that of Assistant Attorney General. To many, this was an indication the Department of Justice did not regard the U.S. Trustee Program as arising to the same level of importance as its other divisions. This was an unfortunate oversight. The present Director of EOUST, Jerry Patchan deserves the title which provides the foundation for a greater degree of prestige with his staff, the public, his colleagues at the Department of Justice, and perhaps, more significantly, with members of Congress.

Frustratingly, the U.S. Trustee Program has been a victim of political vicissitudes. Appointments to positions, particularly at higher echelons, have been governed by party affiliation. The program has thus lacked continuity of leadership. Those involved in the bankruptcy administrative process have had difficulty maintaining a high level of esprit. This has adversely effected the quality of administration. Moreover, the program has lacked a uniformity in policy at the national level.

The House Judiciary Committee held hearings on oversight of the U.S. Trustee Program in 1987, 1989 and 1991. Among those who testified, the critics outnumbered the proponents. Not that this was surprising. The implementation of any new program cannot be accomplished without glitches. Public oversight hearings can sometimes provide a circus like atmosphere where the most disgruntled can publicly give testimony to the more outlandish alleged misdeeds of one or two rogue trustees. Unfortunately, these fact driven narratives seem to receive more publicity than the testimony of the director of the program. In short, Congress has heard more than a few war stories.

The hearings, however, produced a sanguine theme; a perception of tension among the courts, the U.S. Trustee Program and the various creditor and debtor interests regarding administration. Because of the importance of public confidence in the system, the Bankruptcy Review Commission must examine legitimate complaints without eviscerating the power of EOUST to administer effectively. This may be no small task. The Commission should take into consideration the fact that there was bound to be inherent problems in putting a major national program in place over a relatively brief period during a time when there was a dramatic increase in the number of bankruptcy filings.

The Commission must also answer the fundamental question as to whether the Justice Department is best equipped to fulfill the original congressional mandate in administering the U.S. Trustee Program. My answer to this question is unequivocally, yes.

It is difficult for any major administrative changes made in private industry to be accepted by employees without substantial resistance by some who desire to maintain the status quo. In most cases, the objections to changes are self-serving. The problem is magnified in a governmental agency which is bound to bump heads with pavlovian personalities accustomed to operating "by the book." Simply put, old habits are difficult to break.

Despite some initial mistakes, the U.S. Trustee system has evolved into a fairly efficient one. The Justice Department certainly learned an important lesson from the well publicized *Inslaw* case: don't meddle in the bankruptcy process to protect a purely parochial interest. It is a mistake, however, for critics to continue to refer to *Inslaw* as a reason for changing the system. Alleged abuses by the government in bankruptcy cases are rare. That is not to say that other federal agencies may not attempt, on occasion, to influence a regional U.S. Trustee in a given case. It

should not, however, cast an ominous cloud over the system, particularly considering the alternatives.

Let's assume the redesignation of all bankruptcy administrative functions from the Justice Department to the U.S. Courts. The ballpark may change, but it is doubtful that the public will see more home runs. Unfortunately, some abuses will occur as the result of judge influenced appointments of Trustee's counsel, creditors' committees, as well as Court supervising of trustees. This possibility is potentially more insidious than the perceived conflict of interest issue with the Justice Department. A rekindling of the public perception of an "old boy" bankruptcy network is simply unacceptable. While some claim the North Carolina and Alabama administrators operating under the umbrella of the U.S. Courts have experienced few problems, users of the system privately acknowledge that there is favoritism, delay, waste and incompetence in the system. Furthermore, the administrator program is playing catch up with the EOUST in its use of computer technology and networking information on a nationwide basis. Even proponents of the transfer of bankruptcy administration to the U.S. Courts cannot point to certain cost savings or guaranteed greater speed in the administration of cases. Significantly, almost all that has been recently published by those attempting to preserve a niche for U.S. Court administration focus on criticisms of the U.S. Trustee Program as opposed to offering palatable alternatives.

One of the cornerstones of the 1978 Act was the notion of keeping administrative functions separate from judicial ones. That dichotomy has eroded somewhat due to the recent modifications of Section 105(d), which codifies the Court's ability to become a participant in the administration of a Chapter 11 case. In general, however, the concept of separation of judicial versus administrative responsibilities continues to save judicial resources and preserves the integrity of the system.

There are many other issues relating to the U.S. Trustee Program which should be addressed by the Commission, including the following:

PRIVATIZATION

1. Should the Justice Department implement an alternative administrative and management structure that relies on greater involvement by the private sector (so-called privatization) in managing U.S. Trustee Program activities? As a secondary concern, can such privatization be accomplished without creating a new set of problems involving efficiency and expense?

During 1994, perhaps anticipating the appointment of the Bankruptcy Review Commission, the Department of Justice provided a grant to the National Academy of Public Administration (NAPA) to review the USTP. There were two distinct mandates: first, assess the strengths and weaknesses of the program; and, second, determine the feasibility of improving the program possibly through an alternative structure that would rely on greater private sector involvement in managing USTP activities. NAPA filed its final report in May of 1994. Several positive suggestions were made which, if implemented, will potentially shrink the bureaucracy in the USTP and save substantial dollars. The recommendations were largely administrative in nature and the Department of Justice and EOUST have begun to implement them. There is very little for the Bankruptcy Review Commission to consider with respect to the NAPA recommendations with two important exceptions. First, it should discourage the formation of a new governmental agency to operate the system. The emergence of a new government agency to administer bankruptcy cases would create its own problems, even with a saving provision for Justice Department oversight. Unfortunately, the number of people, program and regulations within an agency tend to increase geometrically over time with little impetus. Any new entity would likely experience the same growing pains and problems that the Department of Justice encountered in the early years of the U.S. Trustee Program. A governmental agency will almost certainly result in unnecessary duplication of effort by the hiring of a new cadre having oversight and management responsibilities. Finally, there is the risk that a separate entity will create tension when policies of the agency are out of sync with the philosophy or policies of the Department of Justice.

Second, privatization of certain functions in the USTP is an idea worth trying. To his credit, the Director of EOUST has already started experimental privatization programs in selected districts. Financial monitoring and review functions, collection of quarterly fees, auditing Trustees, reviewing no asset cases, reviewing monthly operating reports and monitoring DIP compliance with administrative requirements are all areas that might well be handled on a large scale effectively in the private sector at less cost to the taxpayer.

JUDICIAL REVIEW OF ADMINISTRATIVE DECISIONS

2. Should decisions relating to the administration of a case made by the U.S. Trustee be subject to "de novo" review by the Bankruptcy Court or, alternatively, be subject to reversal only upon a finding of arbitrary or capricious conduct or an abuse of discretion?

The U.S. Trustees are afforded substantial latitude in the administration of a case. A good example is their ability to appoint a Creditors' Committee at the inception of a Chapter 11 case. Several important decisions are made in conjunction with this mandated function. For example, the U.S. Trustee, under 11 U.S.C. 1102, determines the size and number of Committees and must attempt to insure that a Committee is fairly representative of the kinds of claimants in the case. What happens when a U.S. Trustee for a particular region appoints a Committee, including an insider or holder of a dubious claim or a competitor intending only the liquidation of the debtor? What are the rights of the D.I.P. for a speedy review of appointments and other non-legal decisions made by the U.S. Trustee? Unfortunately, the system is not effective if the Court must limit its reviewing authority to merely determining whether the U.S. Trustee has clearly acted arbitrarily, capriciously or abused his or her discretion. The cases of *In re Gary William Vance,* 120 B.R. 181 (Bankr. N.D. Okla. 1990) and *In re First Republic Bank Corporation,* 120 B.R. 58 (Bankr. N.D. Texas 1988), which limit the Court's ability to deal with factual determinations by U.S. Trustees, should be legislatively laid to rest. The Court must have the ability to review trustees' decisions de novo as the impact on the outcome of a case can be costly and, in some cases, hinder a Debtor's ability to reorganize. This recommendation should not be construed as a denigration of the quality of factual determinations made-by most U.S. Trustees. The fact that there are few appeals from administrative decisions by U.S. Trustees lends credence to the proposition that they are performing ably. However, as there is no statutory standard of review at this time, Congress should mandate the same now to avoid further litigation of this issue. The need for de novo review of all trustee decisions is heightened by the confusing recent amendment to Section 1104, relating to the election of Chapter 11 trustees. The Court requires the ability to promptly review all aspects of the election process, as so much is at stake, particularly in the larger cases where control of the daily operations of the debtor is pivotal.

THE CONSTITUTIONALITY OF THE U.S. TRUSTEE PROGRAM

3. Does the existence of Bankruptcy Court Administrators in North Carolina and Alabama threaten the constitutionality of the U.S. Trustee Program?

What was a hypothetical issue has become a matter of some urgency, as a result of the decision in *St. Angelo* v. *Victoria Farms Inc.,* 38 F.3d 1525 (9th Cir. 1994). The Ninth Circuit held that 28 U.S.C. 1930 is invalid under the uniformity, clause because of the existence of the special provision governing North Carolina and Alabama. The Uniformity clause of the Constitution requires bankruptcy laws to be "geographically uniform." It is clear that creditors and debtors in states other than North Carolina and Alabama are governed by a more costly system for resolving bankruptcy disputes. While this uniformity could conceivably be corrected by a new "user fee" provision substantially similar to the one imposed in the other judicial districts under 28 U.S.C. § 1930, it simply does not make sense to have two separate administrative systems operating in tandem.

DUE PROCESS IN THE REMOVAL OF PANEL TRUSTEES

4. Should the U.S. Trustee's removal process of a Panel Trustee culminate in a "judicial hearing" to assure that "due process" concerns are addressed?

The Courts in *Shaltry* v. *United States,* 182 B.R. 836 (D. Ariz. Jan. 1994) and *Joelson* v. *United States,* 179 B.R. 857 (N.D. Ohio1995) allowed motions to dismiss filed by the Government in response to complaints filed by two former panel trustees claiming lack of due process in their summary dismissal. The Courts said they lacked jurisdiction to hear the cases because the U.S. Trustee was merely exercising its discretion under 28 U.S.C. § 586, which authorized it to maintain a panel of Chapter 7 Trustees. Both Courts found further that the claimants were not entitled to review under the Administrative Procedure Act; the action by the U.S. Trustee was incapable of being reviewed because Title 28 authorizing appointment of U.S. Trustees permits the action within the purview of the agency's discretion. According to the Courts, the statutory language authorizing a Panel Trustees appointment is so vague that a court would have no meaningful standard upon which to judge the U.S. Trustee' 8 exercise of discretion. The question the Bankruptcy Review Commission must address is whether such absolute discretion by the U.S. Trustee discour-

ages competent qualified people from applying and serving on panels when they have no protection against arbitrary dismissal. Assuming that the Bankruptcy Review Commission recommends that dismissed Trustees be provided with an appellate review opportunity, how much harm is occasioned to the system? If an individual Trustee remains suspended from exercising any responsibilities during the appeals process, one can argue that the denial of property and liberty interests should outweigh any perceived administrative necessity of permanent dismissal without appellate review. Certainly, a decision on involuntary termination made by a U.S. Trustee may seriously impact on the ability of an individual to rebuild a legal practice which may have been neglected as the result of substantial devotion of time to Trustee cases. Finally, turnover of Panel Trustees is simply not desirable. It takes months, if not years, for Trustees to acquire a "feel" for the position and a knowledge of local idiosyncrasies, such as multiple filings by individuals, and abuses by certain petition preparers. Perhaps, a middle ground for the Bankruptcy Review Commission to consider is to provide recourse by a dismissed Trustee who has served in the system for one or more years. This may alleviate a possible concern of EOUST that some of its new appointees may not, for any number of reasons, fail to discharge responsibilities required by the guidelines. These individuals, who have not worked out, could be summarily dismissed within the first twelve months. The one-year window can be viewed as a probationary period.

EXTENSION OF TIME TO OBJECT TO DEBTOR'S EXEMPTIONS

5. Should Congress extend the period of time under Bankruptcy Rule 4003(b) to permit Panel Trustees to object to non-allowable exemptions by Debtors?

In *Taylor* v. *Freeland & Kronz et al.*, 112 S.Ct. 1644 (1992), the Supreme Court held that a Chapter 7 Trustee could not contest the validity of a Debtor's claimed exemption after the 30 day period for objections had expired even though the Debtor had no colorable basis for claiming an exemption. Specifically, the Debtor listed a discrimination lawsuit against her employer on her schedules of exempt property. She indicated its value as "unknown." The Trustee failed to object within 30 days, mistakenly believing the suit was worthless. When the Trustee learned the case had settled for $110,000, he filed a complaint for turnover alleging the Debtor had no valid basis for claiming the lawsuit proceeds as exempt. Noting that § 522(1) does not contain a "good faith" requirement, Justice Thomas, writing for the majority, explained that deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality. The result was grossly unfair to creditors of the Taylor estate. Justice Stevens, in a well-reasoned dissent, opined that a Debtor should not be allowed to claim exemptions that are not provided by law and keep property that should be distributed to creditors. Some Courts have attempted to skirt *Taylor's* inequitable result. Judge Conrad Cyr, in a First Circuit opinion, *Mercer* v. *Monzak*, 170 B.R. 759 (1st Cir. 1995), factually distinguished the *Taylor* case to reach the right conclusion. *Mercer* involved a Chapter 7 Debtor who listed the entire potential recovery of a personal injury lawsuit as exempt under Bankruptcy Code §§ 522(d)(10)(C) and 522(d)(11)(E), which allow exemptions for disability benefits and future earnings, respectively. The Debtor conceded the disputed settlement proceeds of $50,000 were neither disability benefits nor lost future earnings pursuant to the Code sections he cited on his schedules. According to the Court, the Debtor had "plainly listed discrete statutory citations" in support of his alleged exemptions. He could not complain when it was later determined the settlement did not meet the relevant statutory prerequisites. *Taylor* and *Mercer* teaches Debtor's counsel to be as vague as possible when describing a client's exemptions! This is not what Congress intended. The Bankruptcy Review Commission can rectify this problem in at least two different ways. First, it can recommend that the doctrine of equitable tolling apply to Bankruptcy Rule 4003(b)'s 30 day limitation period. Second, it can propose amending 522 to provide that the 30 day objection period will not begin to run until the Debtor precisely lists the specific Bankruptcy Code subsections or state exemption statutes under which he or she claims the property or value as exempt.

DEFINING A TRUSTEE'S CIVIL LIABILITY

6. Should Congress amend 11 U.S.C. § 704 to establish legislative parameters to guide the Court and Trustees regarding a Trustee's civil liability?

Although § 704 delineates the duties of a Trustee, it does not describe the standard of care the Trustee must exercise during the administration of a case to avoid the imposition of civil liability. In a seminal case, *Mosser* v. *Darrow*, 341 U.S. 267 (1951), the Court held that Bankruptcy Trustees may be personally liable for breaches of fiduciary duty. Subsequent to *Mosser*, many Courts have attempted to define the scope of the Trustee's "safe harbor." The Bankruptcy Code should provide

that a bankruptcy estate will be liable for a Trustee's ordinary negligence. Trustees, however, should not be held personally liable except for willful and deliberate acts committed in violation of their fiduciary duties. Although Trustees have a duty to conserve the assets of a bankruptcy estate, they should not be held to a higher standard than that imposed on a fiduciary at common law. The Bankruptcy Court in *Kinross Mfg. Corp.,* (W.D. Mich. 1994), had the right idea: the Trustee's duty should be measured against the standard of "the exercise of due care, diligence and skill . . . of an ordinarily prudent man in the conduct of his private affairs under similar circumstances and with a similar object in view." Citing *Ford Motor Credit Corp.* v. *Weaver,* 680 F.2d 451, 461 (6th Cir. 1982). Use of this test will promote uniformity because the case law interpreting this standard of care is well-defined. There is a need to put this issue to rest to encourage Trustees to deal more aggressively with estate assets without fear of personal liability.

LIMITATION ON CIVIL SUITS AGAINST TRUSTEES

7. Should Congress amend 28 U.S.C. 959 to limit civil suits against Trustees in state Courts?

Under 28 U.S.C. 959, Bankruptcy Trustees may be sued without leave of the Bankruptcy Court with respect to any act or transaction "in carrying on business" connected with estate property. During the past several years, individuals, entities and governmental agencies have instituted many actions against Trustees in state Courts, individually and in their representative capacity, for acts or transactions purportedly "in carrying on business" connected with property of the estate. Occasionally, Trustees have successfully obtained an injunction preventing the continuation of litigation against them outside the Bankruptcy Court. However, the results are not uniform. Bankruptcy judges are uniquely familiar with the administration of bankruptcy cases and particularly attuned to the parameters of a Trustee's duties and responsibilities. In contrast, some State Court judges have been less than evenhanded in dealing with a Trustee attempting to administer estate assets. Oftentimes, the financial resources of the individual or governmental agency seeking to hold a Trustee responsible for negligent conduct are inexhaustible compared to a Trustee's means. Frequently, there is no insurance to satisfy a judgment or to pay for defense costs. Assuming a Trustee prevails in state Court litigation, there is a question as to whether the professional time expended is chargeable against the estate. Even if a Bankruptcy Court were to allow a fee application for such defense expenditures, there are many instances in which estate assets are insufficient to reimburse the Trustee. To help alleviate the problem, Congress should amend 959 to provide that a Trustee may only be sued without leave of the Bankruptcy Court for acts or transactions in "actively carrying on business" and only by a governmental unit to enforce such governmental unit's police or regulatory power (not unlike the existing exception to the relief from stay provision stated in 362(b)(4)). Any individual or other entity desiring to commence an action against a Trustee is not seriously inconvenienced by the prerequisite of obtaining Bankruptcy Court permission.

TRUSTEES SHOULD BE PERMITTED TO RETAIN THEMSELVES OR THEIR LAW FIRMS AS COUNSEL

8. Should Congress explicitly authorize Chapter 7 or Chapter 11 Trustees to retain themselves or their law firms as counsel?

In most jurisdictions, the U.S. Trustee's office and Bankruptcy Courts have consciously permitted Chapter 7 and Chapter 11 Trustees to retain their law firm as counsel. However, some Courts and the House and Senate Judiciary Committees have expressed continuing concern that this practice ignores the potential for conflicts of interest. Arguably, such employment violates § 327, which requires a "disinterested" person to represent or assist the Trustee in carrying out the Trustee's duties under Title 11. Despite the appearance of conflict of interest, this practice has not resulted in substantial abuse. A significant number of Bankruptcy Judges agree that, in most cases, no *actual* conflict exists. In any event, the conduct and fees of both a Trustee and Counsel in the administration of any bankruptcy matter is subject to the scrutiny of the United States Trustee and final approval of the Bankruptcy Court. Both Trustees and Counsel must file detailed fee applications in all cases. Indeed, in many reported decisions Courts have either reduced or disallowed fees when the Court found the Trustee's or Counsel's conduct was duplicative or otherwise inappropriate. Although Congress increased the fee structure for Panel Trustees in the 1994 Bankruptcy Reform Act, it still ,remains impractical and economically infeasible for a Trustee to hire another law firm to act as Counsel. Creditors benefit when one office handles the administration of a relatively uncomplicated estate. In smaller cases correspondence and meetings between a Trustee and outside

Counsel are simply not efficient. A National Association of Bankruptcy Trustees' survey indicates that most present Panel Trustees could not afford to remain as Trustees if they could not retain themselves or their law firms to perform the professional work. The system would seriously suffer if it lost a knowledgeable and experienced panel of Chapter 7 Trustees who skillfully perform their duties. There is another reason to continue the present practice. A rule precluding employment of one's own law firm as counsel to a Trustee might prompt the formation of "bankruptcy rings" within a particular community. A Trustee would choose Law Firm A as his/her counsel because it, in turn, would employ the Trustee's law firm when a member of its own firm was appointed as a Trustee. This practice was a curse on the bankruptcy system under the Bankruptcy Act. It was one of the reasons prompting bankruptcy reform in 1978.

CHAPTER 11 TRUSTEES' FEES AS A CHAPTER 7 ADMINISTRATIVE CLAIM

9. Should U.S. Trustee fees assessed against the estate under Chapter 123 of Title 28, due upon conversion from Chapter 11 to Chapter 7, enjoy the same administrative status as other Chapter 7 administration claims?

Section 507(a)(1) of the Bankruptcy Code grants first priority status to administrative expense claims allowed under § 503(b) and fees (including quarterly fees due to the U.S. Trustee) assessed against the estate under Chapter 123 of Title 28. Section 726(b) specifically subordinates administrative expenses incurred prior to conversion and allowed under § 503(b). That Section is silent regarding subordination of fees assessed against the estate under Chapter 123. In an unfortunate decision, in *In re Juhl Enterprises, Inc.*, 921 F.2d 800 (8th Cir. 1990), the Eighth Circuit held that upon conversion from Chapter 11 to Chapter 7, it is permissible to elevate unpaid fees due to the U.S. Trustee during the administration of the Chapter 11 case to equal status with Chapter 7 administrative expenses. According to the Eighth Circuit, because unpaid quarterly fees are not specifically subordinated along with administrative expenses incurred under § 503(b), the unpaid quarterly fees are of equal priority with Chapter 7 post-conversion administrative expenses. Although seven Courts have adopted the reasoning in *Juhl*, it has not been universally followed. *In re Wetmore,* 117 B.R. 201 (Bankr. W.D. Penn. 1990); *In re Ehrman*, 171 B.R. 683 (Bankr. D. Ariz. 1994), *In re Endy*, 166 B.R. 438 (Bankr. D. Nev. 1994). Courts refusing to follow *Juhl* have determined that it is essential to grant Chapter 7 administrative expenses priority over *all* Chapter 11 administrative expenses because that gives fiduciaries who must wind up the Debtor's affairs the proper incentive to do so. This makes sense. Unless Congress specifically authorized the evaluation of Chapter 11 administrative expenses to Chapter 7 status, none should be inferred.

PROPOSED AMENDMENTS TO THE INTERNAL REVENUE CODE

10. Should Congress amend the Internal Revenue Service Code to provide incentives to Chapter 7 Panel Trustees to administer assets of the bankruptcy estate?

In many cases Panel Trustees abandon assets of the estate for fear of incurring tax liabilities. Every time a Panel Trustee walks away from a possible sale of assets for tax reasons, the potential dividend to unsecured creditors is diminished. Two areas deserve the Bankruptcy Review Commission's attention. First, Congress should eliminate or modify the capital gains taxes in Chapter 7 bankruptcy proceedings. Debtors presently retain substantial non-exempt assets because Trustees abandon them given the almost certainty that they cannot satisfy the tax liability. One solution is to authorize a specific sum as exempt from capital gains similar to the exemption provided in the probate of a decedent's estate. As an alternative, Congress can authorize a Trustee to use the one time real estate exemption now available to those over 55 years of age. Congress should also exempt Trustees from filing tax returns when the income generated by the estate is less than, for example, $25,000.00. Such an amendment would greatly reduce paperwork for Panel Trustees and result in fewer abandonments and increased dividend payments. While the IRS has sometimes opposed proposed amendments to the I.R.C. relating to bankruptcy cases, these changes shouldn't have a major impact on revenue production. The actual loss in dollars to the government would be minimal at best. Ultimately, it might increase revenues by better utilization of assets, particularly income producing real estate, which deteriorates quickly from non-use and which Trustees frequently abandon even before they complete administration of the bankruptcy case.

REDUCING BANKRUPTCY FRAUD

11. Does the U.S. Trustee Program have sufficient resources to protect creditors and the public from Debtor fraud?

According to well-respected attorney, Rich Levin, who helped draft the 1978 Bankruptcy Code, one of the problems with the present bankruptcy system is that lawyers, and others, see it as irrelevant because the people in it don't wear black robes. Unfortunately, most cases offer a significant opportunity for fraud. Chapter 7 Debtors' lawyers, some of whom advertise for business in newspapers and television and consequently handle large numbers of cases, fail to devote sufficient time to assure that assets are accurately reported on schedules. Knowledgeable Debtors know they do not have to appear before a judge to receive a discharge. Lack of judicial oversight creates slack in the system. Panel Trustees might suspect a Debtor has secreted assets; but what resources are available to conduct an exhaustive investigation? Not many. In other cases, Panel Trustees have reported suspected fraud cases to the Justice Department. Except in those jurisdictions where bankruptcy fraud units are in place, little or no action evolves from an investigation unless the culprit is a prominent individual or the amount of the fraud is substantial. Although no statistics exist as to the actual cost of Debtor fraud to the public, the loss must exceed tens of millions of dollars. To provide a more judicial setting for Chapter 7 Debtors, the Bankruptcy Review Commission should consider recommending the creation of a regional quasi-judicial position administered by EOUST—for instance, Bankruptcy Magistrate or Administrative Law Judge. This individual would handle referrals from Panel Trustees who suspect bankruptcy petition preparers, Debtors or others of bankruptcy crimes. The Magistrate or Administrative Law Judge, with subpoena powers, would investigate all such allegations, conduct hearings, and make referrals to the Bankruptcy Court for appropriate action. If the Bankruptcy Judge made a criminal referral directly to the Justice Department, that might result in greater zeal in the prosecution of bankruptcy crimes' cases. Congress could empower Magistrates to review all reaffirmation agreements. Today, many Debtors are executing agreements that would not pass Court scrutiny. Aggressive creditors have the ability, once again, to hinder the "fresh start," which Congress deemed to be one of the cornerstones of the 1978 legislation. Finally, the law should require a Chapter 7 Debtor to appear before such a Magistrate or Administrative Law Judge at a final discharge hearing at which time the Debtor's post petition rights and obligations are clearly explained. Something judicial should exist in a federal proceeding in which an individual can discharge substantial indebtedness without meaningful safeguard of creditor rights. Finally, the Bankruptcy Court could use a Magistrate to mediate pending adversarial matters.

PARTIAL EXEMPTION FROM EXCEPTED SERVICE REQUIREMENTS

12. Would a partial exemption from excepted service Justice Department regulations enhance the U.S. Trustee Program?

Today, all individuals who serve in the U.S. Trustee Program are subject to a detailed FBI security clearance, which frequently takes several months. Clearly, a distinction should exist between replacing a secretary in a regional United States Trustee Office and hiring a lawyer at the Justice Department. When a clerk or a secretary resigns from a position, all professional personnel in that office suffer the consequences. Congress did not intend this delay in filling vacancies when it created the U.S. Trustee Program. The FBI should make an exception to ensure the continuity of administrative functions.

CONCLUSION

The U.S. Trustee Program is working quite well despite the occasional glitches which are bound to occur in any nationwide system implemented over a relatively short time span. With proper funding, the U.S. Trustee Program can provide quality field leadership which is essential for the program to succeed in its mission. In doing so, Congress must take care to assure that the U.S. Trustee Program is as non-political as possible. Frequent changes in leadership seriously erode employee morale at all levels. Finally, Congress must elevate the Director of EOUST to the position of Assistant Attorney General, nominated by the President and confirmed by the Senate. This will help the U.S. Trustee Program improve its image with members of Congress and thereby promote changes that will enhance the bankruptcy system.

Mr. GEKAS. We'll let you continue in the context of some of the questions that we want to ask in reverse order. You mentioned—and I didn't think I'd see this phrase used again in my lifetime in the Congress—the *Inslaw* case, where we struggled for years. In

your testimony you referred to it as an example of why we shouldn't be involved in those kinds of cases, but why? That was a symptom of the system gone astray; is that correct?

Mr. GREENFIELD. Yes, Your Honor. Yes. [Laughter.]

I'm too used to being in front of a court.

Mr. GEKAS. That's all right. I understand.

Judge BODOH. I'll defer to the chairman.

Mr. GEKAS. I was going to object to something, [Laughter.]

Mr. GREENFIELD. I was going to say, I usually have to refer to Judge Bodoh as "Your Honor."

Mr. GEKAS. Give us a summary of how *Inslaw* teaches us a lesson.

Mr. GREENFIELD. Unfortunately, in my preparation today I read all the cases that are in my—except we didn't—my law clerk didn't pull *Inslaw*. However, the testimony is that there were alleged abuses by the Government in bankruptcy cases and they're rare, and it's not to say that other Federal agencies may not attempt on occasion to influence a regional trustee. I believe what we're getting at is that the U.S. Trustee needs to be independent and away from the opinions of other Federal agencies. And we believe that they are currently accomplishing that goal.

Mr. GEKAS. Mr. Kennedy——

Mr. KENNEDY. Yes?

Mr. GEKAS [continuing]. You seem to want noninterference from the Congress or from the Senate amendment; is that correct?

Mr. KENNEDY. I read the——

Mr. GEKAS. You're opposed to Grassley?

Mr. KENNEDY. Yes. I think it encourages involvement of the courts in administration. What it does is to allow the bankruptcy court to be involved in an aspect of administration. And to the extent the court is involved in administration, that impairs, as it seems to me, the appearance and the reality of the independence of the court——

Mr. GEKAS. I understand.

Mr. KENNEDY [continuing]. From the administration of the case.

Mr. GEKAS. Do we properly infer from that that you believe the current system contains mechanisms that can solve disputes like that?

Mr. KENNEDY. I'm not sure that it does have the mechanisms that are needed, but I think that to the extent there is a need for more mechanism, it ought not to be in the court but in the Attorney General's organization. I think there may be a need for a mechanism, but I'm saying that we don't want that mechanism to be the court. The court should not be involved in this kind of administration——

Mr. GEKAS. I think you've made your point clear on that. [Laughter.]

Ms. FitzSimon, you mentioned, and others did in their testimony—I'm a little bit taken aback by it. I didn't realize the extent of it, in your noting the problems of nepotism. How in the devil does that occur at such a rampant pace in the bankruptcy system? Give me an example, without mentioning names, of the rules of consanguinity that apply to appointment to bankruptcy court——

Ms. FitzSimon. Well, I'd love to tell you, Mr. Chairman, that I'm too young to know about such things, but, as the Chair is well aware, many of the chapter 13 trustees who are in place today have been in place for 10, 20, 30 years in those jobs, and in a great many instances—and I'll speak directly to one of my own.

I was Acting U.S. Trustee in the Northern District of Illinois from 1982 to 1983. At that time there was one standing chapter 13 trustee in that district. His wife was his assistant at a salary, I think, of somewhere around $75,000 a year. There were a number of cousins and nieces also on their payroll. They belonged to one of the more exclusive clubs in the city of Chicago.

Mr. Gekas. They are a club. [Laughter.]

Ms. FitzSimon. They were a club unto themselves. I have to admit they did not have—they certainly didn't have lavish offices, and they had one of the most antiquated computer systems, but that was the situation I walked into as Acting U.S. Trustee in Chicago.

And that is a situation—now there are certainly circumstances where, for example—and I don't cite this as an actual example, because I don't know it, but I assume that perhaps, if there is a standing trustee in Barrel, AK, it's hard for him to find someone other than family to work for him because I suspect people can make more money working on the pipeline than one would make under the scheme that Congress has set forth for the payment of chapter 13 trustees. In that circumstance, I think it would be entirely appropriate for the Attorney General to recognize that it may be necessary for the trustee to retain family members, et cetera, if there truly is no one else available.

But I can assure you that in Chicago there were a lot of other people available to work for the chapter 13 trustee, particularly in 1982 at a salary of $75,000 a year and not requiring a legal degree. So that's the sort of thing that has gone on.

Mr. Gekas. Thank you.

Mr. Bodoh had mentioned, I think in your summary of your statement, the concern about burdensome control. Were you referring to the court?

Judge Bodoh. No. Let me give you one example, if I may, Mr. Chairman. Congress in the 1994 amendments provided for the enactment, the adoption, of procedural guidelines for the U.S. Trustee to use in its review of fee applications of professionals. I recently saw the first of the full-blown final fee applications under those guidelines, and I found myself, as I was reading through that application, asking myself why I needed to know all this; that it, for example, was breaking down the hours in this case of an attorney between hours the attorney thought were devote to administration of the case and to motions to employ professionals, and so forth, and I had the very strong perception that it was telling me more than I needed to know.

I think the old story of the young girl who was to write an article on grasshoppers and submit it to her fourth grade teacher, and her report was, "I learned more about grasshoppers than I ever wanted to know." Well, that's kind of the way I felt with this. I learned more about the fee application than I really needed to know. And I wonder if maybe that's an example of how the oversight function

of the U.S. Trustee system—because I think that's what Congress intended it to be—the oversight function of that system has become a bureaucratic—it has evolved into a bureaucratic proliferation of requirements which are inconsistent with the needs of the system.

It seems to me that if—and this is my view; I suggest to you this may not necessarily be the view of the American Bankruptcy Institute, but my own personal view, Mr. Chairman, if one of the reasons there is this kind of proliferation of local rules throughout the country, depending on which region you are in, is what Ms. FitzSimon alluded to, and that is that the executive office of U.S. Trustee just does not have the oversight of the individual U.S. Trustees that I believe Congress intended when you originally provided by legislation to create that system.

For example, it was my understanding that Congress intended that the head of that office would be an assistant U.S. Attorney, but that is not how it has turned out. And it seems to me that the Justice Department has not carried out the intention—if not the mandate, certainly the intention—of Congress in that regard.

Mr. GEKAS. It isn't the first time.

But I think we'll end this session with polling the panel of witnesses on the question of the Grassley amendment. I have an inkling, but I will make it official. We'll start with Mr. Bodoh. Yes or no?

Judge BODOH. I am not opposed to it if——

Mr. GEKAS. You can't abdicate your responsibility.

Judge BODOH. No, if Congress wants me to do that, I'll be glad to do it; I'm on salary. [Laughter.]

Mr. GEKAS. Ms. FitzSimon.

Ms. FITZSIMON. No, and I'd like to have the opportunity to explain that.

Mr. GEKAS. You'll have to submit that for us, and we'd like you to submit it.

Ms. FITZSIMON. Thank you.

Mr. GEKAS. Mr. Kennedy.

Mr. KENNEDY. No.

Mr. GEKAS. No?

Mr. Greenfield.

Mr. GREENFIELD. It's very consistent with our paper, and we support it.

Mr. GEKAS. Thank you very much. We end the session with a note of thanks from the chairman.

The subcommittee is adjourned.

[Whereupon, at 12:30 p.m., the subcommittee adjourned.]

APPENDIX

DEPARTMENT OF JUSTICE RESPONSES TO SUBCOMMITTEE QUESTIONS

QUESTION 1. The House Judiciary Committee report on the Bankruptcy Reform Act of 1978 states that the United States Trustees "will be more responsible for the day-to-day operations of the bankruptcy system. They will supervise trustees, assist them in the performance of their duties, oversee their actions and see to it that the bankruptcy laws are properly executed." Critics interpret this to mean a role for the UST that is less intrusive, less given to what they term micro management and less hostile to decentralization and trustee flexibility than they allege has in fact been the case. Please provide us with your response to this criticism.

The role of the United States Trustee Program (USTP or Program) stems from two basic premises of the 1978 Reform Act. The first premise was that the judicial functions of the system should be separated from its administrative aspects. The second and perhaps more fundamental premise was that these administrative functions -- the oversight of debtors and private trustees -- should be committed to one accountable agency. The United States Trustees (USTs) were charged with the task of supervising the administrative functions of the system. The goal was to provide more accountable and consistent oversight, and to supplant the disparate procedures emanating from separate judicial districts.

The USTs' broad umbrella of duties assigned to USTs include the duty to monitor the progress of cases to prevent undue delay, to monitor compensation, to ferret out fraud, to monitor the hiring of professionals, and to perform a host of other duties to ensure the laws are properly observed and enforced. While each subject of the USTs' oversight -- be it the trustee, the debtor, a creditor, or a professional -- might prefer to act without limitations, the system and other parties in that system benefit by having an independent party scrutinize the subject's activities for compliance with applicable law and bring matters that require resolution to the court's attention. That is precisely the role that Congress envisioned for the USTs.

One of the principal subjects of the USTs' supervision is the standing or panel trustee. A trustee is a fiduciary in the classic sense, holding substantial sums of money that belong to third parties. As a result, the trustee must adhere to basic standards. The policies by which the USTs carry out their supervisory responsibilities over trustees are based not only on the foregoing premise but on their experience that problems, particularly embezzlements, can and do occur.

The USTs' role as supervisors often makes them a target for criticism, particularly by those who are subject to supervision. To some degree, such tension is inherent in the system. While the USTP is not insensitive to these criticisms, the track record of the organization demonstrates that it is committed to carrying out its statutory responsibility in a balanced manner. The

Program has recognized the need to respond to changing circumstances, to reduce the administrative burden on the trustees when feasible, to allow for flexibility, to manage its own limited resources efficiently, and to assure effective bankruptcy administration.

For example, the Program's chapter 7 subcommittee has recently developed recommendations to make chapter 7 trustee reviews more flexible and focused on those offices that may demonstrate a higher risk of financial or case administration problems. Existing chapter 7 guidelines require audits of all trustees on a biennial basis. These guidelines, combined with background investigations, improved reporting requirements and training and evaluation, have accomplished many of the Program's goals. As performance has improved and consequential audit deficiencies have decreased, the Program has concluded that the frequency of audits can be reduced in a manner that will not sacrifice the quality of the Program's overall oversight efforts or the ability to target trustee deficiencies.

In addition, the Program's oversight of standing trustees appointed in cases under chapters 12 and 13 has also evolved in response to changing needs. Perhaps no issue has generated as much controversy in recent years, or led to more concerns about "micro-management," than recent attempts by the Program to set forth a clearer articulation of the fiduciary standards to which the Program expects standing trustees to adhere when handling trust fund money.[1] The Program's focus on the chapter 13 area revealed some problems with the use of trust fund monies to pay for actual and necessary expenses. Some standing trustees were charging fiduciary trust funds for services at sums far above market rates, or for unnecessary or unsubstantiated expenses. Some trustees used fiduciary trust funds to improperly subsidize their businesses or law firms. Other trustees used trust funds to pay for theater tickets, aerobics instructors, discount store memberships, parties, family vacations, parking fines, and tax penalties.

While the abuses discussed above are not pervasive, there are sufficient problems in this area to warrant more definitive guidance on what the standing trustees should expect and how the USTs should exercise their discretion to challenge expenses. USTs have previously received complaints from standing trustees

---

[1]Standing trustees collect a percentage fee of all the monies they receive in each case to pay for their compensation and "actual, necessary expenses." The percentage fee is fixed by the Attorney General after consultation with the United States Trustee. The Attorney General's authority to fix percentage fees and compensation has been delegated to the Director. By law, the percentage fee cannot exceed 10 percent.

that their decisions were ad hoc and varied widely from region to region. By introducing uniform standards for the conduct of standing trustees, we believe standing trustees can adjust their conduct accordingly, and avoid the need for interference by the USTs.

The use of fiduciary trust funds involves important ethical considerations. Because the law limits standing trustees to those expenses that are actual and necessary, standing trustees have a fiduciary duty to maximize the return to creditors. Each United States Trustee exercises his or her supervisory responsibilities to monitor the expenditures of the standing trustee to ensure compliance with the mandates of the Bankruptcy Code.

Throughout the process of developing these standards, the Program has endeavored to work with the standing trustees to respond to their questions and concerns, and actively solicited suggestions in the course of developing the standards. The fiduciary standards which proscribe the employment of relatives and other relationships with related parties have been published as a proposed rule in the Federal Register for notice and comment. Adherence to the standards should assist the fair and impartial administration of the office of the standing trustee and help maximize the efficiency and purpose of case administration.

Bankruptcy is a national practice, and consumer bankruptcies are big business. Given the significant responsibilities and sums of money that are entrusted to standing trustees, it is eminently reasonable that they should be made to account for their positions of trust in a reasonably uniform manner.

QUESTION 2. Why has your budget increased from $64.3 million in FY 1991 to about $102 million in FY 1996, while in the same period, the number of your employees has only risen from 929 to 1,050? What percentage of your budget went for personnel costs in FY 1991? in FY 1996? What percentage went to other major categories of expense?

The budget increases from 1991 through 1996 are largely due to what are known as mandatory costs such as the annual cost-of-living allowances (COLA), locality pay, within grade and administrative salary increases, increased rent costs, and general pricing level (GPL) adjustments to meet the cost of inflation for goods and services established by a market system. COLAs are established by law. Other mandatory adjustments are established by OMB on an annual basis. Of the $37.9 million increase in the Program's budget between 1991 and 1996, $22.8 million is attributable to such mandatory costs.

Program increases unrelated to mandatory costs were attributable to staff increases. The first increase, approved by Congress in fiscal year 1992, supported 186 new positions at a cost of $11.6 million. The second increase, approved by Congress in fiscal year 1994, supported 36 new positions at a cost of $3.4 million. These staff increases were offset by reductions in staff the last two years, budget decreases related to streamlining, and overall attrition.

The chart below displays United States Trustee Program expenses by major category from 1991 through 1995, with an estimate for 1996. While there are some minor variations, spending by category has not changed significantly over the 6-year period. Notably, while personnel costs have risen over the last 5 years, that increase is primarily due to mandatory adjustments, such as health benefits and locality-based pay increases.

Expense Category	1991 Act.	1992 Act.	1993 Act.	1994 Act.	1995 Act.	1996 Est.
Salaries and Benefits	65.5%	62.1%	68.6%	69.0%	68.8%	67.8%
Travel and Transportation	3.9%	4.1%	2.9%	2.5%	2.7%	2.5%
Rent and Communications	15.8%	16.1%	16.6%	17.6%	17.0%	16.9%
Supplies and Equipment	4.2%	5.8%	3.6%	2.3%	2.1%	5.3%
Other[1]	10.5%	12.0%	8.3%	8.6%	9.4%	7.5%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

[1] Other expenses include contracts with other governmental agencies and non-governmental entities for such items as printing and reproduction, advertising, equipment maintenance, audits, space renovation, court reporters, tuition and training, security investigations, automated legal research, ADP systems development, financial records charges, drug testing, graphics, quarterly fees collection contracts, and electronic data transfer from the Bankruptcy Courts.

QUESTION 3. The Senate has adopted an amendment to S. 1559, the Bankruptcy Technical Amendments Act, providing that district courts shall have the authority to review disputes regarding the actual, necessary expenses of standing trustees and discontinuance of assignment of cases to standing trustees. In both instances, substantial deference is to be accorded to the determination previously made and it may be reversed only if there has been an abuse of discretion. In view of your current efforts to perfect an administrative review process to cover these matters, is judicial review desirable and/or acceptable? On what grounds would you support or oppose such changes in a judicial review proposal as extension of appeal rights to cover chapter 7 panel trustees or mandating review of expense and removal appeals by the bankruptcy court instead of the district court?

The Director of the United States Trustee Program has made a commitment to develop formal administrative procedures that will apply to both standing trustees and to chapter 7 panel trustees and that will enable them to seek internal review of certain decisions made by agency officials. The establishment of these procedures will allow a court to review certain final agency actions taken by the USTP; under current law, district court review of final USTP actions is not available. See Joelson v. United States, 86 F.3d 1413 (6th Cir. 1996) (UST's decision not subject to judicial review in the absence of guidelines upon which court can base its review); Shaltry v. United States, 1996 WL 866862 (9th Cir. June 26, 1996) (same).

We believe the administrative procedures will render the proposed legislation unnecessary. Those procedures will provide both chapter 7 trustees and standing trustees with a process by which they can challenge actions taken against them by Program officials and should enable trustees to seek further review in the district court. In addition, because we believe that the legislation as a whole is unnecessary, we oppose adding panel trustees to the bill's provision.

We would also oppose any attempt to change district court review to bankruptcy court review for several reasons. In the first instance, any review by the bankruptcy court of administrative decisions made by Program officials signals a return to the premise that was rejected by the Reform Act of 1978. The USTP was created as a mechanism for separating the judicial aspects of the bankruptcy system from the administrative aspects. Allowing the bankruptcy court to "second guess" the Program on administrative issues would undoubtedly diminish the Program's credibility and supervisory authority.

Secondly, once final regulations have been promulgated, trustees will be able to use the review process established under the Administrative Procedure Act (APA) to secure review of final

agency actions. The district courts are far more familiar with the protocol for conducting judicial review of agency action than are the bankruptcy courts.

QUESTION 4. What are your guiding criteria as the EOUST currently constructs an internal grievance procedure to address disputes relating to expenses, retention, suspension, removal and other issues?

Until now, the Program has used an informal process to resolve grievances. Whenever a panel or standing trustee disagreed with the resolution of an issue at a certain level, the trustee could seek to have the matter reviewed at a higher level in the organization's management.

The Program is currently in the process of formalizing these internal procedures, to clarify the manner in which trustees can seek review of administrative actions taken by United States Trustees. Because of the range of actions trustees may wish to appeal, and the need for a swifter resolution of certain matters than others, more than one process is being considered. As we are still in the deliberation stage, the precise nature of the review and how and by whom it will be conducted have yet to be finalized. We plan to consult with the appropriate trustee groups to ensure that their concerns are addressed in developing a proposal. The over-arching goal for this internal grievance procedure is to guarantee that trustees have a public, fair, and timely process available to them to resolve disputes. Accordingly, whatever process is adopted will ensure that trustees will be given notice of the United States Trustee's action and, where appropriate, an opportunity to cure or respond.

QUESTION 5. Why is it difficult to obtain court approval for actions proposed to be taken against errant Chapter 7 panel trustees? Is denial of reappointment necessarily your only means of discipline?

Under current law, the UST has the statutory responsibility both to appoint trustees and to supervise their performance in cases. If the UST encounters problems with a chapter 7 panel trustee, there is only one administrative tool at the UST's disposal. The UST can stop assigning cases to the trustee either on a temporary basis to see if performance improves, or permanently (i.e., permanent removal from the chapter 7 panel). This tool may be used only for future case assignments; the UST may not remove the trustee form an existing case without court approval. The court is the sole arbiter of what constitutes sufficient cause to remove a trustee from present cases, pursuant to § 324 of Title 11 of the U.S.C.

As the "for cause" requirement has been in place for a number of years predating the 1978 Bankruptcy Reform Act, certain legal standards have developed. The courts have established a fairly high threshold of "cause" in order to oust an incumbent trustee. See e.g. In re Freeport Italian Bakery, Inc., 340 F.2d 50 (2d Cir. 1965); In re BH & P, Inc., 949 F.2d 1300 (3d Cir. 1991); In re Reed, 178 B.R. 817 (Bankr. D. Ariz. 1995); In re Lundborg, 110 B.R. 106 (Bankr. D. Conn. 1990); In re Haugen Const. Service, Inc., 104 B.R. 233 (Bankr. D. N.D. 1989). In the absence of fraud or actual injury, the likelihood of being able to remove a trustee for misfeasance or nonfeasance is slight.

In contrast to the "cause" that must be shown in order to remove a trustee from existing cases, the UST's decision to stop assigning cases to a trustee likely would be rooted in managerial concerns related to efficiency and effectiveness of general case administration. Tardy case administration, failure to respond to inquiries or to cooperate with creditors or debtors, inadequate recordkeeping, or chronic deficiencies are all examples of behavior that, while not rising to the level of fraud or direct injury needed to remove a trustee in an existing case under §324(a), may justify a UST's decision to stop assigning future cases for managerial concerns, either on a permanent or temporary basis.

In addition, whenever the UST has reason to believe that estate funds are missing or unaccounted for, the UST's first response is to stop assigning future cases until the matter can be reviewed more thoroughly. If prior court approval were required, the UST's ability to investigate the situation properly could be thwarted. For example, if the proposed action were disputed in court, the parties could become engaged in protracted discovery, or the underlying merits of the USTs action could be debated, thus inhibiting the UST's investigative efforts. To avoid this possibility, the UST may well be forced to continue assigning cases until an investigation is complete. It is unclear what would transpire if a criminal prosecution eventually ensued.

Another concern about requiring broader judicial review is that a UST may legitimately decide to stop assigning cases to a trustee for reasons unrelated to performance. The case load in a particular region may decline, or the geographic needs may shift, thereby necessitating fewer trustees, or trustees in different locations who possess certain expertise.

Finally, if a court decided, contrary to the UST's determination, that the UST should continue to assign cases to a faltering trustee, it would directly impact the Program's resources. Trustees with a history of poor or lax administration demand more supervision and consequently more resources from the UST. Due to their oversight responsibilities, and their ultimate responsibility for the administration of cases within their

region, it is only appropriate that the USTs retain the prerogative and flexibility to stop assigning cases to an individual in whom they have lost confidence.

Eliminating the only administrative tool USTs have to encourage cooperation from trustees would create a disincentive for trustees to work cooperatively with the UST. We believe that since the UST has the authority and discretion to appoint trustees, at the very least, the UST should be able to exercise that same discretion to stop appointing a trustee to cases.

QUESTION 6. The suggestion was made at the Subcommittee hearing that Chapter 7 panel trustees should be provided with complete copies of their annual evaluations. Would you agree to this?

Absolutely. The United States Trustees have already been advised, orally and by memorandum, to forward evaluations to the affected trustees. In addition, the practice is being formalized in a revised chapter 7 initiative that is now being circulated for comment.

QUESTION 7. What steps can United States Trustees take to encourage every standing trustee to be more cost-conscious when the marketplace itself does not regulate the expenses of Chapter 13 trustees or force them to economize? Is there reason to believe that the new prescriptive language in the standing trustee's handbook will be effective?

The collective experience of the USTs underscores the need to revise the Program's Handbook for standing trustees, in order to encourage each trustee to determine the most cost-effective method of running the trust operation consistent with fiduciary standards. The new Handbook provisions set forth clear and reasonable guidelines for standing trustees to follow and will enable USTP officials to evaluate fairly the reasonableness of a standing trustee's budget request. By providing for such matters as community standards and local wage rates as a measure of appropriate employee expenses and benefits, we are confident that the limits and procedures set out in the Handbook will be effective and will ultimately result in a less contentious budget process.

QUESTION 8. Do all United States Trustees apply the same standard in determining "actual, necessary" expenses? If not, why not?

Generally, yes. The USTs apply the standard of what is reasonable and necessary to the standing trustee's administration of cases, but it should be understood that the application of

this standard will not always lead to the same results. "Actual, necessary" expenses have two components: one component is the type of expense; the other is the amount of the expense.

As to the former category, the USTs agree in principle that certain types of expenses are appropriate for a standing trustee. These are reflected in the budget categories such as employee expenses, rent, computer charges, etc. As to the amount of a particular expense, however, the standard is far more difficult to apply and, in the past, has bred misunderstandings between the UST and the standing trustee. To alleviate these problems, the USTs decided to develop a set of written standards to provide guidance both to themselves and to the standing trustees. The new provisions in the standing trustee handbook establish standards and procedures that, if followed, should streamline the budget process and eliminate previous areas of disagreement.

Because the USTs' determination of allowable expenses is driven by what is reasonable both for fiduciary in general and in the circumstances of a particular standing trustee, the results will vary to accommodate local needs. Some standing trustee perform a wider variety of functions than other trustees, including, for example, those of the clerk of court in mailing notice and maintaining the official claims register. These differences contribute to different needs in each standing trustees operational budget.

Bankruptcy is a national practice and while all USTs adhere to the same principle, the determination of what is actual and necessary may not be the same for all standing trustees everywhere in the country. The Program has recently published for notice and comment a proposed rule setting forth fiduciary standards to aid the Director and the USTs in supervising this area. Thus, despite the diversity in results, uniform standards still guide the process.

QUESTION 9. Are regional and local variations in the United States Trustee program unavoidable? To what extent are they desirable?

The United States Trustees share a common understanding of the organization's goals and mission, but some variation is inevitable in the specific ways in which they accomplish those goals and carry out their responsibilities. Most significantly, the USTs' responsibilities are inextricably linked to cases pending in the federal court system. To the extent courts vary, the USTs must also vary their supervisory role to adapt to court decisions and local rules and procedures.

Variation is also a necessary component of the duties and the discretion that are vested in the UST. The USTs' duties require

evaluation and the exercise of judgment. See, e.g., 28 U.S.C. § 586(a)(3)(A) and (G) (duty to monitor applications for compensation and duty to monitor the progress of a case). In matters that require judgment, people can vary in their approaches or reasoning but still work toward the same goal and even achieve the same result. That aptly describes the USTs. Discretion also enables the USTs to allocate their resources in a manner that most meets the needs of the bankruptcy system in their regions, yet covers all the major areas of Program responsibility. For example, one area of the country may devote extra resources to combating an outbreak of petition mills, while another may have a backlog in old chapter 7 cases they want to address.

QUESTION 10. What is your comment on the May 1995 National Association for Public Administration recommendations that the United States Trustee Program should eliminate its regional management layer, consolidate field offices and contract out debt collection and a variety of financial monitoring and review functions.

In the FY 1995 budget process, the Office of Management and Budget recommended that the Department look at privatizing the United States Trustee Program. As a result of that request, the National Academy of Public Administration (NAPA) was commissioned by the Attorney General to conduct a 6-month study of the Program, and to assess the feasibility of privatization. In its report, NAPA credited the U.S. Trustee Program with improving the integrity of the bankruptcy system and concluded that bankruptcy oversight was an inherently governmental function. Thus, it rejected complete privatization as inappropriate for bankruptcy administration but made some recommendations for privatizing certain functions and for making further improvements in the Program.

Many of NAPA's suggestions were incorporated in the Administration's FY 1997 budget submission and the Program's restructuring proposal. The budget request includes several pilot projects to test alternative means of performing several of our functions, using contract personnel and increased technology. One pilot project will enable the Program to test the feasibility of using video teleconferencing technology to improve communications, to reduce travel costs associated with mandatory meetings of debtors and creditors, and to interact with the bankruptcy court. Another proposed pilot project tests the feasibility of using contract personnel and automation to review fee applications, in order to reduce the amount of attorney staff time spent on these reviews. In the area of debt collection, we have recently implemented 3 pilot projects to test ways of improving our performance through the use of contract personnel.

The Program also concurs with, and is moving forward on, NAPA's recommendation that we reduce the scope and intensity of our chapter 7 trustee oversight. The Chapter 7 Initiative is being revised, and the contract with the Office of the Inspector General to conduct trustee audits has been reduced to reflect the fact that the Program has determined, due to improved performance and fewer audit deficiencies, the number and intensity of audits can be reduced. These revisions will carry out NAPA's recommendation that the Program make trustee reviews more flexible and focus on those trustees whose operational profile demonstrates a higher risk of financial or case administration problems.

The Program's 1997 appropriation also provided for a structural reorganization that will reduce regional administrative staff and respond to shifts in caseload through the use of attrition and relocation of existing employees. In regard to reducing the number of regions from the present 21 to 11, which would coincide with the number of regional federal judicial circuits, we have urged the National Bankruptcy Review Commission to consider this proposal.

QUESTION 11. The NAPA report on the United States Trustee program states that the USTP "has not focused its mission, but has steadily expanded the number of functions it performs." Since your appointment as director of the Executive Office for United States Trustees, what steps have you taken to focus your mission and limit your functions?

When Mr. Joseph Patchan assumed the position of Director of the Executive Office for U.S. Trustees, one of his first official duties was to rewrite the Program's mission statement and to widely distribute it among the Program's offices and staff. The statement is as follows:

> "The United States Trustee Program acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. It works to secure the just, speedy, and economical resolution of bankruptcy cases; monitors the conduct of parties and takes action to ensure compliance with applicable laws and procedures; identifies and investigates bankruptcy fraud and abuse; and oversees administrative functions in bankruptcy cases."

The Program's responsibilities are delineated in statute at 28 U.S.C. § 586. This mission statement embodies the key functions of the Program.

We have strived to maintain a constant presence in all major areas of our responsibility, but at the same time, we have periodically shifted our emphasis among these various areas to

address identified problems. While some might perceive the shift in emphasis to be an expansion of functions, we do not think that is necessarily the case.

Looking back to 1989, when the nationwide expansion had largely been completed, as required by statute, the Program's first challenge was to tackle the large backlog of pending chapter 11 cases that were clogging court dockets everywhere. Once that task was finished, the Program then turned its attention to the chapter 7 area, in order to eliminate the backlog in that chapter and to devise more effective strategies to monitor trustees and to keep cases moving.

As noted earlier, the Program has adopted a number of the suggestions of the NAPA report. We propose to establish pilot projects that will test the use of new technology and contract personnel to streamline the way we perform certain functions. We have designed and are moving toward implementing a structural reorganization that reduces and streamlines management layers, and we are working to make the oversight process more flexible by rewriting our initiatives and targeting audits at high risk areas.

Finally, access to Program operations and policies has been increased by actively soliciting and welcoming outside comments and constructive suggestions from the bankruptcy bench and bar, national bankruptcy associations, and the general public. An advisory board has been created where bankruptcy judges join with U.S. Trustees to review comments, receive presentations from the bench and bar, and discuss policies and initiatives. For the first time in history, the Program solicited public comments on its policies, e.g., the Professional Fee and Expense guidelines, and the Chapter 13 Ethical Standards. These policies have been revised to incorporate the comments and suggestions received. The Program will continue this invitation for public comment during the early stages of policy development.

In summary, we have taken steps to focus our mission, streamline the management layers in our organization, increase the flexibility of our oversight and open up our policy-making processes to the bankruptcy community and the public. The development of a strategic plan will further assist us in making the organization more effective and focused as it continues down this path.

O

ISBN 0-16-053733-9

90000

9 780160 537332